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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 108

COMMISSIONER OF INTERNAL REVENUE, ET AL.,
PETITIONERS,

vs.

P. G. LAKE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 17, 1957

CERTIORARI GRANTED JUNE 3, 1957

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 108

COMMISSIONER OF INTERNAL REVENUE, ET AL., PETITIONERS,

VS.

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[fol. a] [Caption omitted]

[fol. 1] **IN THE TAX COURT OF THE UNITED STATES**

DOCKET NO. 48684

P. G. LAKE, INC., Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

APPEARANCES

For Petitioner: Harry C. Weeks, Esq.
For Respondent: Paul M. Newton, Esq.

DOCKET ENTRIES

1953

May 22—Petition received and filed. Taxpayer notified. Fee paid.

May 27—Copy of petition served on General Counsel.

Jul. 23—Answer filed by General Counsel.

Jul. 23—Request for hearing in Dallas, Texas filed by General Counsel.

Jul. 28—Notice issued placing proceeding on Dallas, Texas calendar. Service of answer and request made.

1954

Dec. 14—Hearing set February 14, 1955, Dallas, Texas.

[fol. 2] 1955

Feb. 14—Hearing had before Judge Murdock on the merits. Stipulation of facts and exhibits A thru H filed at hearing. Briefs due 4/15/55. Replies due 5/16/55.

Mar. 28—Motion for extension to May 15, 1955 to file brief filed by General Counsel. 4/5/55 Granted both parties.

Mar. 29—Transcript of hearing 2/14/55 filed.

May 5—Petitioner's opening brief filed. Copy served.

May 10—Motion for extension of 30 days or to 6/14/55 to file brief filed by General Counsel. 5/12/55 Granted to May 31, 1955.

1955

May 31—Brief filed by General Counsel. Copy served 6/1/55.

Jun. 3—Stipulation to correct transcript filed.

Jun. 13—Reply brief filed by taxpayer. Copy served.

Sept. 20—Opinion filed, Murdock, Judge. Decision will be entered under Rule 50. Copy served 9/20/55.

Dec. 29—Agreed computation filed.

1956

Jan. 18—Decision entered, Murdock, Judge, Div. 3.

Apr. 9—Petition for review by United States Court of Appeals, Fifth Circuit, with assignments of error filed by respondent.

April 23—Proofs of service filed. (2).

May 14—Certified copy of order of Court of Appeals, Fifth Circuit, directing that original exhibits received and made a part of the record before the Tax Court, including those attached to the stipulation of facts, be transmitted as [fol. 3] a part of the transcript of record on review, filed.

May 16—Agreed praecipe for record file.

* * * * * * *

IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

PETITION—Filed and received—May 22, 1953

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols DIR:DAL:A:90-D), dated April 24, 1953, and as the basis of its proceeding alleges as follows:

I

The petitioner is a Delaware corporation with its principal office at 858 Fair Foundation Building, Tyler, Texas. The returns for the period here involved were filed with the Collector of Internal Revenue for the Second Collection District of Texas at Dallas, Texas.

[fol. 4] II

The deficiency notice (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on April 24, 1953.

III

The deficieneies, as determined by the Commissioner, are in income and excess profits taxes for the calendar years 1949, 1950, and 1951, in the following amounts:

1949:		
Deficiency in income tax		$9,060.79
1950:		
Deficiency in excess profits tax	$76,607.70	
Deficiency in income tax	35,895.46	
Total deficiency in income and excess profits tax		112,503.16
1951:		
Deficiency in income tax		12,026.24

All of said excess profits tax and substantial portions of the asserted deficiencies in income tax for each of said years are in controversy.

[fol. 5] IV

The determination of tax set forth in said deficiency notice is based upon the following errors:

(a)—In each of the years 1949, 1950 and 1951, the respondent erroneously treated amounts paid for "transferred allowables" and "substitute royalties", as those terms are hereinafter more fully explained, as royalties paid by petitioner for the purpose of computing petitioner's allowance for depletion, with respect to certain oil and gas leases operated by it, under Section 114(b)(3) of the Internal Revenue Code.

(b)—The respondent erroneously determined that petitioner received in 1950 ordinary depletable income from certain oil and gas leases, rather than long-term capital gains, from the sale of a limited overriding royalty or oil payment interest in said oil and gas leases, and in not determining that said sale produced long-term capital gain to petitioner, taxable as such under Section 117 of the Internal Revenue Code.

V

The facts upon which the petitioner relies as the basis for this proceeding are as follows:

(a)—During all of the times pertinent to this proceeding, petitioner was primarily engaged in the business of

acquiring and developing oil and gas properties and producing oil and gas therefrom. During all of said times, petitioner's books and records and its tax returns were kept, maintained and made up the accrual basis and for [fols. 6-9] calendar year periods. The properties of petitioner directly involved in this proceeding, and hereinafter more fully referred to, were oil and gas leaseholds on lands in what is known as the East Texas Oil Field, each of which leaseholds petitioner had owned for several years prior to 1949. During the entire period of its ownership of said leaseholds, and each of them, petitioner held the same for productive use in its trade or business and not for sale.

(b)—The operation of oil and gas properties in the aforesaid East Texas Oil Field, together with the amount of oil which can be produced from oil wells and oil and gas leases in that field are, and were at all times pertinent hereto, under the control of the Railroad Commission of Texas, and during all pertinent times the Railroad Commission of Texas exercised its jurisdiction and authority over producing operations in that field. The Railroad Commission of Texas from time to time fixed the amount of oil per day and per month which could be produced from oil wells and oil and gas leases in that field; the amount of such permitted production being ordinarily referred to as the "allowable" oil production.

* * * * * * *

[fol. 10] (g)—In 1950, petitioner was indebted to P. G. Lake of Tyler, Texas, in the total sum of $600,000, which indebtedness was evidenced by petitioner's notes then held by the said P. G. Lake. In payment of this indebtedness petitioner, in 1950, assigned to the said P. G. Lake limited overriding royalty or oil payment interests, by which the said P. G. Lake became the owner of one-fourth (1/4) of 7/8ths of the oil and gas then under the aforesaid Owens and Reid Leases owned by petitioner, and entitled to that percentage of the oil to be produced therefrom until he, the said P. G. Lake, had received oil of the value of $600,000, plus an amount equal to that which interest would produce on the declining balance of $600,000 remaining from month to month unsatisfied, the amount equal to interest to be

calculated at the rate specified in said conveyance. In its tax return for the calendar year 1950, petitioner treated this transaction as a sale of capital assets for the sum of $600,000, and the resulting profit as long-term capital gain, taxable to it as such under Section 117 of the Internal Revenue Code. In determining the deficiency here involved, the respondent refused to treat said transaction as a sale of capital assets, but treated said $600,000 as a part of petitioner's gross income from the respective properties, sub-
[fol. 11] ject to allowances for depletion, and the gain, as so calculated, as ordinary income. Petitioner alleges upon information and belief that it correctly reported and treated its gain from said transaction in its 1950 tax return, and that the respondent's action, as above outlined, was erroneous.

Wherefore, the petitioner prays that this Court may hear this proceeding and determine that the respondent erred in each and all of the respects hereinabove set forth; that the deficiencies so determined by respondent against petitioner be redetermined in accordance herewith; and that petitioner may have all of the other and further relief to which it may be justly entitled under the facts alleged.

Harry C. Weeks, 525 Fort Worth National Bank Bldg., Fort Worth, Txas, Attorney for Petitioner.

Weeks, Bird, Cannon & Appleman, of Counsel.

[fol. 12] *Duly sworn to by P. G. Lake. Jurat omitted in printing.*

IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

ANSWER—Filed July 23, 1953

Comes now the Commissioner of Internal Revenue, by his attorney; Kenneth W. Gemmill, Acting Chief Counsel, [fol. 13] Bureau of Internal Revenue, and for answer to

the petition filed in this proceeding, admits and denies as follows:

I, II and III

Admits the allegations in paragraphs I, II and III of the petition.

IV

(a) and (b). Denies that respondents determination is based upon errors as alleged in subparagraphs (a) and (b) of paragraph IV of the petition.

V

(a). Admits the allegations in the first three sentences and for lack of information denies the remaining allegations of fact in subparagraph (a) of paragraph V of the petition.

(b). Admits the allegations in the first two sentences and for lack of information denies the remaining allegations of fact in subparagraph (b) of paragraph V of the petition.

(c). For lack of information denies the allegations of fact in subparagraph (c) of paragraph V of the petition.

(d). Denies the allegations of fact in subparagraph (d) of paragraph V of the petition.

(e). Admits the allegations in the first sentence and denies the remaining allegations of fact in subparagraph (e) of paragraph V of the petition.

[fols. 14-29] (f). Admits the allegations in the first sentence and denies the remaining allegations of fact in subparagraph (f) of paragraph V of the petition.

(g). Admits the allegations in the first sentence and denies the remaining allegations of fact in subparagraph (g) of paragraph V of the petition.

Denies generally and specifically each and every allegation in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner of Internal Revenue be approved.

(Signed) Kenneth W. Gemmill, ATA, Acting Chief Counsel, Bureau of Internal Revenue.

Of Counsel: James L. Backstrom, Regional Counsel; Allen T. Akin, Acting Appellate Counsel; John W. Alexander, Special Attorney, Bureau of Internal Revenue.

JWA:pg 7/17/53.

[fol. 30] IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

STIPULATION OF FACTS—Filed February 14, 1955

The parties to the above styled and numbered cause now pending before the Tax Court of the United States, acting herein by and through their respective attorneys of record, hereby agree and stipulate that upon the trial of said cause the facts hereinafter set out shall be accepted as true, without any proof other than the filing of this stipulation as a part of the record in said cause; but the making and filing of this stipulation of facts shall not be or be construed as a waiver by either party of such party's right to introduce upon the trial of this cause such other and further evidence not inconsistent with the facts hereby stipulated as such party may see fit to offer. The facts so stipulated are as follows:

1

The petitioner, P. G. Lake, Inc., is a corporation chartered under the laws of Delaware with its principal office in Tyler, Smith County, Texas. It is engaged in the business [fol. 31] of producing oil and gas. Petitioner keeps its books and records and makes its income tax returns for calendar year periods and uses the accrual method of accounting. Petitioner's income and excess profits tax returns for the calendar years involved in this proceeding (1949, 1950 and 1951) were filed with the Collector of Internal Revenue for the Second Collection District of Texas, at Dallas, Texas. These returns showed the following income tax liabilities, the amounts of which were duly paid to said Collector of Internal Revenue:

For the calendar year 1949	$ 4,359.85
For the calendar year 1950	266,568.55
For the calendar year 1951	124,916.14

2

On December 29, 1950, petitioner owned the 7/8ths working interest in two commercial oil and gas leases from which it, as the operator, was then producing oil in substantial quantities. These leases are known as the Mrs. V. E. Reid Lease in Rusk County, Texas (covering 120 acres more or

less) and the Owens Lease in Gregg County, Texas (covering 290 acres more or less). Petitioner had owned these properties continuously for several years prior to December 29, 1950, and each property was held by petitioner for productive use in its trade or business of producing oil, and not for sale.

3

On said date of December 29, 1950, petitioner was indebted to P. G. Lake, its President, in the sum of $600,000. [fol. 32] On said date of December 29, 1950, petitioner, in consideration of the cancellation of said indebtedness of $600,000 by the said P. G. Lake, executed and delivered to P. G. Lake an instrument with respect to its said Reid and Owens leases, which instrument (omitting field notes of the properties involved, signatures and acknowledgments) was in words and figures as follows:

STATE OF TEXAS,
County of Smith:

Whereas, P. G. Lake, Inc., a corporation, is the owner of certain oil, gas and mineral leases located in Gregg and Rusk Counties, Texas, and briefly described as follows:

Lease No. 1

A certain oil, gas and mineral lease known as the Mrs. V. E. Reid Lease, and covering the following described property located in Rusk County, Texas, to wit:

(Field notes omitted)

Lease No. 2

A certain oil, gas and mineral lease given by J. P. Owens and wife Willie Owens to J. A. Reynolds, on August 1, 1930, and duly recorded in Volume 78, page 394, Gregg County Deed Records, and which oil and gas lease covered certain lands located in the David Meredith Survey, Abstract 131, and the Charles P. Hereford Survey, Abstract 106, located in Gregg County, Texas, the properties covered

[fol. 33] by said oil and gas lease, by a recent survey of same, being described as follows:

(Field notes omitted)

Now, therefore, know all men by these presents:

That P. G. Lake, Inc., acting herein by and through its proper officers, thereunto duly authorized by a resolution of its Board of Directors hereunto duly passed and entered, hereinafter referred to as Grantor, for and in consideration of the sum of Ten Dollars ($10) and other good and valuable consideration to it in hand paid by P. G. Lake, hereinafter referred to as Grantee, the receipt of which is hereby acknowledged, does hereby Bargain, Sell, Assign and Convey unto the said Grantee, his heirs and assigns, such an interest in said oil and gas leases, and each of them, so that the said P. G. Lake Grantee, shall own twenty-five per cent of seven-eights (25% of 7/8ths) of all oil and gas in, under or upon such leases and each of them, and shall be entitled to receive twenty-five per cent of seven-eighths (25% of 7/8ths) of all the oil, gas and other minerals produced, saved and marketed from the above described oil and gas leases and leasehold estates, from and after 7:00 a.m. January 1, 1951, until said Grantee, his heirs and assigns, shall have received by virtue of this interest the sum of Six Hundred Thousand Dollars ($600,000), net to him after the payment of all pipe line and gross production taxes attributable to said interest, plus an amount equal to interest at the rate of three per cent (3%) per annum payable monthly on the entire unpaid balance of said original sum remaining from month to month unsatisfied.

[fol. 34] The 25% of 7/8ths of the oil and gas thereby assigned to said Grantee shall be forever free and clear of any expense of developing, maintaining or operating said leasehold estates, and all costs of producing and marketing said products shall be borne by Grantor, and Grantor shall save and hold Grantee forever harmless of any such costs. Grantor shall likewise promptly pay off and discharge all ad valorem taxes that may be assessed against the interest hereby conveyed to Grantee, and the proceeds of said 25% of 7/8ths of the gross production shall be paid directly to the

said Grantee, his heirs and assigns, by any pipe line company or other purchaser of oil or gas from said premises.

The parties hereto shall, from time to time, execute such transfer orders, division orders, or instruments of like character necessary in order to carry into effect the terms and provisions of this conveyance and to facilitate the orderly handling transportation and sale of the oil and gas produced from said leases.

And when the Grantee shall have received the full net sum of $600,000 plus an amount equal to interest thereon as hereinabove provided for, from the proceeds of the sale of 25% of 7/8ths of all of the oil and gas produced and saved from the above described leases, then this conveyance shall terminate and the interest hereby assigned shall revert to and revest in the Grantor, its successors and assigns, and Grantee shall execute and deliver an instrument of reconveyance of said interest, and any such other papers as may be necessary to replace the title in Grantor.

[fol. 35] To have and to hold the above described interest unto the said P. G. Lake, his heirs and assigns, forever, subject to the terms and conditions of this conveyance.

This instrument is executed in duplicate, each of which, for the purpose of filing, shall be considered as an original. This is done to facilitate filing both in Gregg County and Rusk County.

In testimony whereof, P. G. Lake, Inc. has caused this instrument to be executed by its Vice-President, attested by the Secretary, and the corporate seal affixed thereto, this the 29th day of December, 1950.

(Signatures and Acknowledgments Omitted)

4

Following the execution and delivery of the instrument set out in the preceding paragraph by petitioner to P. G. Lake, transfer orders in the usual form were executed and delivered to the pipe line companies which were then running and purchasing the oil produced from said properties, directing the payment to P. G. Lake of the proceeds from the sale of 25% of seven-eighths of the oil and gas produced from said Reid and Owens Leases effective at 7:00 a.m. January 1, 1951, until he, the said P. G. Lake, had received oil and gas of the value specified in said instrument

above set forth. In accordance with this order, the pipe line companies purchasing said oil and gas paid P. G. Lake directly for said share of the oil and gas, beginning with [fol. 36] oil and gas produced during the month of January, 1951, and continuing until February, 1954, at which time the said P. G. Lake had received oil and gas of the value specified in the foregoing instrument. Thereupon, the rights of the said P. G. Lake under said instrument terminated, and he executed and delivered to P. G. Lake, Inc. an instrument evidencing this termination. On December 29, 1950, it could have been estimated with reasonable accuracy that it would require three years or more for the said Owens and Reid Leases to produce sufficient quantities of oil and gas so that 25% of seven-eighths thereof would have a value equal to the amount of oil and gas to which P. G. Lake was entitled under and by virtue of the foregoing instrument.

5

In its income and excess profits tax returns for the calendar year 1950, the petitioner reported the transaction summarized in the preceding paragraphs 2, 3 and 4, as a sale producing a profit of $600,000 taxable as long-term capital gain. In determining the deficiency here involved for the calendar year 1950, the respondent treated said sum of $600,000 (less $660 representing the cost of United States documentary stamps affixed to the aforesaid instrument of December 29, 1950) as ordinary income as to which depletion was allowable, with the following explanation:

> "The $599,340 represents net amount received from sale of oil payment to P. G. Lake in December 1950. The amount is reported on return as sale of capital assets. It is held to be the advance sale of oil and taxable as ordinary income in accordance with General Counsel's Memo 24849, Internal Revenue Cumulative [fols. 37-50] Bulletin 1946-1, p. 66. Depletion is allowed on this income in adjustment (d) below."

6

Throughout the years involved in this proceeding, and for many years prior thereto, the Railroad Commission of Texas had and exercised jurisdiction over oil and gas well drilling and oil and gas producing activities within the

State of Texas, including the oil and gas field known as the East Texas Oil Field, in which all of the properties hereinafter referred to were located. In the exercise of this jurisdiction, the Railroad Commission of Texas from time to time fixed the amount of oil per day and per month which could be produced from oil wells and oil and gas leases in the East Texas Oil Field, the amount of such permitted production being ordinarily referred to as the "allowable" oil production. * * *

* * * * * * *

[fol. 51] 15

On June 1, 1953 (this proceeding having been filed on May 22, 1953), petitioner caused to be transmitted to the Director of Internal Revenue at Dallas, Texas, its check in favor of said Director for the sum of $133,590.19. A true and correct copy of the letter by which said check was transmitted is attached hereto and marked Exhibit H for identification. Said check was accepted by said Director of Internal Revenue and duly deposited and collected by him on or about June 2, 1953. The proceeds of said remittance were deposited by said Director in the said Director's Suspense account No. 93-566. No notice was given to petitioner that said check had been deposited in said suspense account.

In Witness Whereof, the parties to the above styled and numbered proceeding, acting by and through their attorneys of record, have executed this stipulation in several counterparts, each of which shall be considered an original, this 9th day of February, 1955.

Harry C. Weeks, Attorney for Petitioner. (S.) R. P. Hertzog, A.T.A., Acting Chief Counsel, Internal Revenue Service, Attorney for Respondent.

[fol. 52] IN THE TAX COURT OF THE UNITED STATES

Docket No. 48684

P. G. LAKE, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

24 T. C. No. 114

Capital Gain—Oil and Gas—Undivided Interest in Minerals in Place Until Production Equalled a Stated Amount. —The petitioner realized long-term capital gain and not ordinary income when in 1950, in consideration of the cancellation of an indebtedness of $600,000, it transferred 25 per cent of 7/8ths of all oil and gas upon two leases owned by it to its creditor until such time as the payments received by the latter equalled the amount of the debt plus interest thereon.

Depletion Allowance—Oil and Gas—Substitute Royalties —Transferred Allowables.—The gross income derived by the petitioner from the operation of two oil leases was not subject, for the purpose of determining the depletion allowance under section 114(b)(3) of the Internal Revenue Code of 1939, to the exclusion of amounts paid by petitioner in 1949, 1950 and 1951 to another oil company for transferred allowables and to royalty owners of a third lease owned by petitioner as substitute royalties, as a result of which the [fol. 53] petitioner was permitted by the Railroad Commission of Texas to produce additional oil from the first two leases.

Harry C. Weeks, Esq., for the petitioner.
Paul M. Newton, Esq., for the respondent.
(Seal.)

OPINION—Filed September 20, 1955

MURDOCK, *Judge:* The Commissioner determined deficiencies in income tax of $9,060.79 for 1949, $47,459.09 for 1950 and $12,026.24 for 1951 and a deficiency in excess profits tax for 1950 of $65,044.07. Two issues are presented for decision. One is whether the petitioner realized a long-

term capital gain from the sale in 1950 of a portion of an interest in two oil and gas leases. The facts relating to this issue have been fully stipulated and the stipulation on this and the other issue is adopted, together with all exhibits, as findings of fact in this case.

The petitioner is a Delaware corporation which filed its returns for the taxable years with the collector of internal revenue for the second district of Texas. It was engaged in developing oil and gas properties and producing oil and gas.

The petitioner was indebted to P. G. Lake in the amount of $600,000 on December 29, 1950 and on that date, in consideration of the cancellation of that indebtedness, sold and transferred to him 25 per cent of 7/8ths of all oil and gas upon two leases, entitling him to receive that portion of all production from the leases beginning at 7 a.m. January 1, 1951, until he had received $600,000 net to him, plus an amount equal to 3 per cent per annum payable monthly on the unpaid balance of the $600,000. The petitioner had [fols. 54-59] owned the leases for several years prior to December 29, 1950, and had always held them for productive use in its business and not for sale. The petitioner reported the entire consideration of $600,000 as long-term capital gain on its return for 1950, but the Commissioner, in determining the deficiency, held that the $600,000, less the cost of documentary stamps affixed to the conveyance, was ordinary income subject to the allowance for depletion.

It was held that the petitioner correctly reported its gain from this transaction upon authority of the following cases which the Commissioner concedes are adverse to his contention: *Lester A. Nordan*, 22 T.C. 1132, in which the appeal of the Commissioner to the Court of Appeals for the Fifth Circuit was dismissed on June 8, 1955; *John David Hawn*, 23 T.C. 516, in which the Commissioner's appeal is now pending in the Court of Appeals for the Fifth Circuit; and *Caldwell* v. *Campbell*, 218 F. 2d 567. See also *Wm. Fleming, et al.*, 24 T.C. ÷ (7/29/55).

* * * * * * *

[fols. 60-90] Reviewed by the Court.

Decision will be entered under Rule 50.

[fols. 91-93] IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

DECISION—Entered January 18, 1956

The parties filed an agreed computation on December 29, 1955, pursuant to the Court's Opinion filed September 20, 1955. Therefore, it is

Ordered and Decided, That there are overpayments in income tax for the years 1949, 1950 and 1951 in the respective amounts of $1,646.88, $110,099.16 and ",459.85, which amounts were paid after the mailing of the notice of deficiency.

J. E. Murdock, Judge. Served Jan. 19, 1956.

[fols. 94-116] Clerk's Certificate to foregoing paper omitted in printing.

[fol. 117] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 118] MINUTE ENTRY OF ARGUMENT AND SUBMISSION—December 3, 1956.

(Omitted in printing)

[fol. 119] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16126

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

versus

P. G. LAKE, INC., Respondent.

Petition for Review of Decision of The Tax Court of the United States (District of Texas).

OPINION—February 1, 1957.

Before Hutcheson, Chief Judge, and Holmes and Borah, Circuit Judges.

HUTCHESON, Chief Judge: This appeal by the commissioner from one of a series of adverse decisions [1] of the Tax Court presents the single question whether $600,000 received as consideration for an assignment of overrid-[fol. 120] ing oil payment interests limited to $600,000 carved out of two oil and gas leaseholds or working interests [2] is taxable to the seller as ordinary income subject to

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[1] Lake v. Commissioner, 24 T.C. 1016; Fleming v. Commissioner, 24 T.C. 818; Wrather v. Commissioner (not officially reported); Weed v. Commissioner, 24 T.C. 1025; and Slagter v. Commissioner, 24 T.C. 934 (7 Cir.)

[2] The respondent is a Delaware corporation with its principal office in Tyler, Texas, engaged in the business of producing oil and gas, and on Dec. 29, 1950, it owned the 7/8 working interest in two commercial oil and gas leases from which it, as the operator, was then, and for several years had been, producing oil in substantial quantities.

On Dec. 29, 1950, respondent was indebted to P. G. Lake in the amount of $600,000, and on that date, in consideration of the cancellation of that indebtedness, it sold and transferred to Lake "such an interest in said oil and gas leases * * so that the said P. G. Lake, Grantee, shall own twenty-five percent of seven-eighths of all oil and gas in, under or

depletion rather than, as the Tax Court held, as long term capital gains under Sec. 117 of the 1939 Internal Revenue Code.

Here vigorously assailing the decision of the Tax Court in this and the other cases, on the ground that they were [fol. 121] all based on the premise that all oil payment assignments constitutes sales of capital assets entitled to capital gains treatment under Sec. 117, and declaring, "That premise was specifically rejected in the Hawn case", the commissioner thus continues:

> "In the present case, as in some of the other appealed cases, the assignor was a leasehold owner which created the oil payment right, not just, like the taxpayer in Hawn, the owner of a larger oil payment right. For that reason, the case calls for an even more

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upon such leases and each of them, and shall be entitled to receive 25 percent of 7/8 of all the oil, gas and other minerals produced, saved, and marketed from the above described oil and gas leases and leasehold estates, from and after 7:00 a.m., January 1, 1951, until said Grantee, his heirs and assigns, shall have received by virtue of this interest the sum of $600,000 net to him * * *".

The assignment also assured that he should have a royalty owner's status, that is that his 25 percent of the 7/8 of the working interest should be free and clear of any development or production expenses.

It finally provided that after grantee had received the full net sum of $600,000, with interest as provided, from the proceeds of the sale of said 25 percent of 7/8, the conveyance shall terminate and the interest assigned "shall revert to and revest in the grantor, its successors and assigns, and grantee shall execute and deliver an instrument of reconveyance of said interest, and any such other papers as may be necessary to replace the title in grantor".

On Dec. 29, 1950, it could have been estimated with reasonable accuracy that it would require three years or more for the leases to produce oil and gas of the value in amount to which grantee was entitled in the assignment. The actual pay out period was from Jan., 1951, to February, 1954, a little over three years.

basic application of the anticipatory assignment of income rule than did Hawn. Not only that, any attempt to treat the oil payment assignment as a sale of property according to ordinary property law concepts merely confirms the conclusion that it was an anticipatory assignment of income.

"Our position here in no way conflicts with this court's decision in Caldwell v. Campbell, 218 F(2) 567 where * * * the assigned oil payment rights were carved out of royalty interests * * *".

Having thus, as he thinks, cleared the ground for an all out and unembarrassed attack on the Tax Court's ruling, the commissioner assails it: (1) as contrary to our decision in Hawn's case in that it treats as substantial an interest which, under the teachings of that decision, is insubstantial; (2) in that what was here transferred was not any part of the leasehold interest, the "property representing income producing property, the vendor's capital investment", it was a transfer merely of a right to receive future income and, under the teachings of [fol. 122] *Burnet* v. *Harmel*, 287 U.S. 22, and the Corn Products case, 350 U.S. 46-52,[3] it was not entitled to Sec. 117 preferential treatment; (3) in that, if contrary to No. (2) above, the oil payment is treated as a sale of income producing property, it had not been held for six months because it did not come into existence until the oil payment was created; and (4) in that the property sold was the oil itself and thus was property "primarily held for sale in the ordinary course of business", and specifically excluded from capital gains treatment.

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[3] "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by Sec. 117 applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' Burnet v. Harmel, 287 U.S. at 106.".

In reply to these contentions, respondent, insisting that all prerequisites to long term capital gains treatment, if there was a sale of "property" or "real property used in the trade or business" within Sec. 117 I.R.C. of 1939, are here present, urges upon us that whether or not there was such a sale here is ruled by *Ortiz Oil Co.* v. *Commissioner*; 102 F(2) 508 and *Caldwell* v. *Campbell*, 218 F(2) 567, and not by *Commissioner* v. *Hawn*, 231 F(2) 340.

Arguing that the first two cases treat similar transactions to these as sales, that the Hawn case is clearly distinguishable and that petitioner's arguments have heretofore been rejected by this Court in *Caldwell* v. *Campbell*, respondent points out that a glance at the table of cases [fol. 123] in commissioner's brief and in the brief of Collector Campbell in *Caldwell v. Campbell* will show that commissioner's opposing arguments here are but an expanded repetition of those advanced in that case.

Insisting that the transaction under consideration was an assignment of a part of respondent's property interests in the two leases, the respondent cites in support *Commissioner v. Fleming*, 82 F(2) 324; *Colorado Oil & Gas Co. v. Commissioner*, 118 F(2) 459; *Thomas Peckham Oil Co. v. Commissioner*, 115 F(2) 685; *Lee v. Commissioner*, 126 F(2) 825; and *Fleming v. Campbell*, 205 F(2) 549.

They recall too that the Supreme Court of the United States, this court, the Supreme Court, and the Intermediate Appeal Courts, of Texas[4] have held that oil and gas leases, royalty interests, overriding royalty interests, and oil payments are interests in land, and that the Texas courts have held that these interests, are subject to ad valorem taxes, to statute of frauds treatment as real estate, and in cases of intestacy pass as real estate.

On the commissioner's general position that oil payments carved out of working interests differ from royal-

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[4] Waggoner Estate v. Wichita County, 273 U.S. 113; Thomas vs. Perkins, 301 U.S. 655; cases cited in footnote 2 (p. 568) of Caldwell v. Campbell, 218 F(2) 565; Sheffield v. Hogg, 124 Tex. 290; 77 SW(2) 1021; Stephens County v. Mid-Kansas Oil & Gas Co., 113 Texas 160; 254 S.W. 290; W. T. Waggoner Estates v. Sigler Oil Co., 118 Texas 509; 19 SW(2) 27; Tennant v. Dunn, 130 Texas, 285.

ties so carved, respondent, quoting from *Tennant v. Dunn, supra*, at page 290:

> "The interest assigned or conveyed by the instrument is in the nature of an overriding royalty. The [fol. 124] assignment gives to Mrs. Dunn, as the reservation of an ordinary overriding royalty gives to or retains in the grantor or assignor, the right to a certain quantity of oil taken from the land, delivered as it is produced, free of charges or expenses of production or operation. * * * It is our opinion that the instrument under consideration conveys an interest in the land * * * "

points to the uniform course of decision that oil payments are in law and in fact of the same nature, indeed are identical, with royalties, except that a royalty is not limited as to duration and an oil payment is.

To commissioner's third contention that respondent did not have the requisite six months holding period for the oil payment interest conveyed, *a contention on its face requiring the wholly untenable postulate that respondent, in and by the act of conveying the oil payment, acquired it*, respondent points to its complete refutation in the stipulation that *respondent had owned and held the leases for productive use in its trade or business of producing oil and not for sale for several years prior to* Dec. 29, 1950, and to the fact that it is obvious that what respondent conveyed, and the only thing that it could convey, was a part of the estate which it acquired in the acquisition of the leases.

As to his fourth contention, that, in assigning an interest in the leases, *respondent did not assign any part of the property held by it for producing income but assigned merely the oil, the property held for sale in its daily business*, and that this must be so *because the interest of any* [fol. 125] *oil payment owner is only in the oil as personal property*, respondent quotes from the leading case of *Tennant v. Dunn, supra*, in which, after stating that the particular instrument in question in that case, which carved an oil payment out of a working or leasehold interest, *did not purport to convey oil in place*, and that the ultimate right of Mrs. Dunn was a right to a certain quantity of oil

after it was produced from the well, the same to be delivered to her free from any charges for production or operation, went on to say:

> "*It does not follow, however, that the instrument does not create an interest in land or that it evidences merely a debt to be paid out of oil produced. The oil and gas leases operated to invest the lessee with a determinable fee in the oil and gas in place.* * * * *The instrument above set out under which Mrs. Dunn claims follows the form ordinarily used by a lessee in assigning or conveying an interest in the leasehold estate.* It is not a promise to pay money. *It is not a contract for the sale and delivery of oil, as personalty after production, but it undertakes to invest the assignee, and we think it invests her, presently with a right or interest in what the assignor owned.* * * * *A part of the lessee's right or interest is assigned,* not a fractional interest in the entire leasehold estate but the absolute right, without charges for production or operation, to a fractional part of the oil as and when it is produced from a well on the leased land, until the assignee has received oil of the total value of $25,000. *The total quantity of oil to be delivered to the assignee is not a fixed fraction of the entire production and is not a cer-* [fol. 126] *tain number of barrels, but it is measured by value according to a specified standard.* (p.290) * * *"The gist of the opinion in Sheffield v. Hogg is that oil and gas royalties, whether payable in kind or in money,* * * * *should be adjudged to be present interests in land rather than merely rights in personalty at some uncertain date, because they are profits arising out of land and further because such classification, which accords with the practice in the oil and gas industry furnishes a stability highly important, if not essential to the structure of the business.* * * * (p.292.)
>
> "The fact that Mrs. Dunn's purchase of the interest was highly speculative and that she might realize either nothing or very large profits does not affect the nature of the interests. Most investments in oil properties or production are speculative. Mrs. Dunn did not become by virtue of the assignment a mining partner or a joint adventurer, *for it gave her, not merely a part of the profits of the enterprise, but an interest in land,*

free of charges for development or operation and without obligation to share in losses; and under the assignment she had no right to engage, and did not in fact engage, in the operation of the leased land or of the well. * * *" (p.294) (all emphasis supplied.)

Finally, it is respondent's position that in the light of the views above expressed, this court is bound by the settled law of the cases, including particularly *Ortiz Oil Co. v. Commissioner*, 102 F(2) 508; *Fleming v. Commissioner*, 205 F(2) 549; *Caldwell v. Commissioner*, 218 F(2) 568; and *Commissioner v. Hawn*, 231 F(2) 340; and the cases [fol. 127] they cite and rely on, to hold that the tax court was right and its judgment must be affirmed.

For the reasons hereafter stated, we find ourselves in complete agreement with these views.

Taking up the grounds put forward by the commissioner for reversal and rejecting, on the stipulated facts, note 2, *supra*, and for the reasons fully stated in *Scofield v. O'Connor*, F(2) just decided, the first ground that this court's decision in Hawn's case requires a contrary holding to that made below, we take up to consider in their turn the second, third, and fourth grounds.

These grounds, as we think we shall show, while put forward by the commissioner as presenting new and sound reasons for persisting in his contention that a sale of oil payments is not a sale of capital assets entitled to capital gains treatment, merely give a superficially new look to and faultfully reargue the old contention. This is accomplished by basing the new argument upon a series of unfounded assumptions as to, and the failure to recognize, the already settled state of the law on the matters discussed.

It is, of course, not conclusive against the commissioner's arguments put forward here for the first time in support of his unyieldingly held and persistently urged general contention, that sales of oil payments are not entitled to capital gains treatment, that they have been put forward in this form in no prior litigations or in the Tax Court in the cases under review here.

[fol. 128] It is, however, significant that the profound discovery announced and urged for the first time on this appeal, that the sale of an oil payment carved out of a working interest in its legal aspects differs from the sale

of an oil payment carved out of an oil interest, has heretofore escaped the attention of judges, lawyers, text writers, and commentators. As far as our information or observation goes, none of the many litigations arising out of or connected with oil payments, none of the decisions, state or federal, dealing with oil payments carved out of a leasehold estate and holding that they are in the nature of overriding royalties, none of the many textbooks, law reviews, or briefs which have dealt with oil payments, have drawn the distinction the commissioner now seeks to draw between oil payments carved out of leasehold interests and those carved out of royalty interests.

This significance is heightened by the fact that the commissioner, as we understand, concedes that overriding royalty interests carved out of working interests or to which working interests are subject are in nowise different from royalty interests reserved to or granted by the owner of the fee.

In short, a careful consideration of the long and involved arguments put forward in the briefs in these cases in support of the commissioner's new look and view make it plain we think that, *viewed not as proposals for legislation*, in which case wholly different considerations would apply, but as restatements of the law of the decided cases, they rest on demonstrably false premises whose discovery and exposure they cannot survive.

[fol. 129] The first of these premises is that the assignment of an oil payment carved out of a leasehold estate is not an assignment of a part of the interest conferred by the lease, a premise precisely refuted in Dunn's case.[3] This

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[3] "It does not follow, however, that the instrument does not create an interest in land or that it evidences merely a debt to be paid out of oil produced. The oil and gas leases operated to invest the lessee with a determinable fee in the oil and gas in place. * * * The instrument above set out under which Mrs. Dunn claims follows the form ordinarily used by a lessee in assigning or conveying an interest in the leasehold estate. It is not a promise to pay money. It is not a contract for the sale and delivery of oil, as personalty after production, but it undertakes to invest the assignee, and we think it invests her, presently with a right or interest in what the assignor owned. * * *"

premise repeated and affirmed over and over stems from the failure of the commissioner to understand, or his unwillingness to recognize, the nature of such an oil payment, a refusal or failure having nothing to do with the substance and reality of the transaction under review, or with the decisions in point.[6] It arises, in short, entirely out of his giving the word "payment" its dictionary meaning where used alone as the satisfaction of a debt or obligation, instead of in the phrase "oil payment" the clearly understood meaning as a part of a technical descriptive phrase used in conveying carved out interests in oil, a meaning which the decisions have ascribed to and fixed for it when used in the connection under consideration here.

[fol. 130] An examination of the many cases, federal and state, which have dealt with oil payments, shows that, without varying, the courts have treated alike oil payments whether carved out of the working or the royalty interests, and that the so-called distinction between them, which the commissioner urges here, has never been made before.

It is, we think, completely fallacious to say that an oil payment carved out of a leasehold interest stands any differently in law from an oil payment varved out of a royalty interest, and it is only by the repetition of the incorrect statement, that they do stand differently, that the argument is, or can be, called an argument.

The commissioner's new approach, therefore, that in this case, because the oil payment was carved out of a working interest, there was not a sale of income producing property, a part of the leasehold interest, but merely of oil as per-

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[6] "* * * we have directed attention to the fact that the interest assigned to Mrs. Dunn, if not in principle the same as a royalty, particularly an overriding royalty, is very like it. We believe we may take judicial knowledge of the common practice in the industry as to the method of paying royalties or other interests in oil. Many owners of royalties and like interests have no facilities for receiving oil, and the ordinary practice is that the owners of such interests, whether payable in oil or in money, obtain payment in money after executing division orders to pipe line companies or other purchasers of the oil." Tennant vs. Dunn, 130 Texas, at p. 294.

sonal property after it is produced, is seen to be in complete contradiction of the law of the cases.

Equally fallacious is the commissioner's fourth point, that, assuming that he is incorrect in contending that the sale of the carved out oil payments was not the sale of a capital asset, held for production of income but was an anticipatory sale of the income itself, what respondents sold, though a capital asset, is merely the oil itself, "property held primarily for sale", and therefore, the sale comes within the express exception from Section 117.

In the first place, the Supreme Court of Texas, in *Tennant v. Dunn, supra*, saying "*It is not a contract for* [fol. 131] *the sale and delivery of oil as personalty after production*, but it undertakes to invest the assignee, and we think it does invest her, presently with a right or interest in what the assignor owned" (emphasis supplied), expressly negatives the commissioner's contention that royalty payments are conveyances of the oil as personalty.

In the second place, it is no more sound to say that the carving out of an oil payment out of a working interest and the sale of the oil payment thus carved is a sale of the oil as personalty, than it is to say that the carving of a royalty out of a working interest and its sale is such a sale, and no one, not even the commissioner, has yet been heard to claim that the carving of a royalty out of a working interest places the owner of the leasehold estate in the position of merely selling the oil itself as personalty and, therefore, that the sale was, within the Sec. 117 exception, of property held primarily for sale. Indeed, the commissioner concedes that "an oil payment assignment may sometimes constitute the sale of a capital asset as where a person who owns only an oil payment right sells the entire right." Thus, as applied to the case at bar, though according to the commissioner the taxpayer did not sell Lake a capital asset, Lake somehow acquired one, and if he later sold the whole of what he bought, the purchaser from him would acquire a capital asset, a truly remarkable result.

The commissioner does not enlighten us on whether in the purchaser's hands the oil which Lake would receive from year to year on the wasting capital asset so acquired would be subject to depletion, but we must assume that

it would not, since, contrary not to some but to all of the cases on depletion, the commissioner has concluded here [fol. 132] that this putative capital asset was depletable in a lump sum in favor of respondent in the year of the sale, even though not a barrel of the oil had been then drawn.

Of the commissioner's third contention, that the sale was not of property held for more than six months, it is sufficient to say that the parties have stipulated, and the facts show, that the properties out of which the interest was carved had been held for more than that time and that the commissioner's contention, that the property sold came into existence with, and only with, its assignment, is contrary to legal principles indeed, is little short of legal legerdemain.

This brings us at last to what in our opinion is the crowning inconsistency of the commissioner's whole argument. This is that the government, through the commissioner, has the right and power to remake or reinterpret their contract for the parties, so that, though according to the teachings of all the cases,[7] the assignee and not the assignor of a mineral interest, under instruments like those here, is entitled to take depletion on it, the commissioner can by his intervention deprive the assignee of his contract right to depletion in the years following and require the assignor to take it all in the year of the sale before the right to it has arisen. Of course, if the instrument transferred an economic interest in the oil, the commissioner cannot do this.

The Court of Appeals for the Seventh Circuit recognized this in the Slagter case in which treating the arrangement [fol. 133] there made as a loan and a dedication of the assigned interest in the oil properties to the repayment of that loan, it is held that the assignors were taxable on the transaction not when they obtained the cash paid for the assignment but that the "income in question was taxable as ordinary income of the taxpayers (assignors) as it accumulated and was paid from time to time to Ashland, and

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[7] Some of these are: Anderson v. Helvering, 319 U.S. 404; Burnet v. Harmel, 287 U.S. 103; Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25; Caldwell v. Campbell, 218 F(2) 567; Kirby Petroleum Co. v. Commissioner, 326 U.S. 599.

that the tax liabilities should be computed for the years in question upon the amounts thus realized and paid to Ashland in the respective periods."

While we incline to the view that, in its opinion in the Slagter case, the Court of Appeals did not give full effect to the true nature of a limited overriding royalty or oil payment interest as announced in *Thomas v. Perkins*, 301 U.S. 655, *Anderson v. Helvering*, 310 U.S. 404, *Caldwell v. Campbell*, *supra*, and numerous other decisions of this court, it is not necessary for us to determine whether the case was or was not correctly decided on its facts. It is sufficient to say of it that nothing said in it or in its result gives any aid or comfort to, or in anywise supports the contention of the commissioner, as applied to the facts of this case, and that we are of the clear opinion that the decision of the Tax Court was right and should be affirmed.

[fol. 134] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16126

COMMISSIONER OF INTERNAL REVENUE,

versus

P. G. LAKE, INC.

JUDGMENT—February 1, 1957

This cause came on to be heard on the petition of Commissioner of Internal Revenue for a review of a decision of the said Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby, affirmed.

[fol. 135] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 136] [Caption omitted]

[fol. 137] CAPTION

Be it remembered, that at a regular term of the United States District Court in and for the Western District of Texas, which said term began at the Austin Division on the 12th day of June, 1955, the Honorable Ben H. Rice, Jr., United States District Judge, presiding, and holding a session at San Antonio, Texas, there came on to be heard on the 4th day of November, 1955, among other causes on the docket, the following cause:

Civil Action No. 824

DENNIS M. O'CONNOR AND KATHERINE O'CONNOR, INDEPENDENT Executors of The Estate of Thomas O'Connor, Deceased, and Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman, Joined by her husband, D. H. Braman, and Thomas O'Connor, Jr.

versus

FRANK SCHOFIELD, Former Collector of Internal Revenue

And, afterwards, at a term of said Court which began at the said Austin Division on the 23rd day of January, 1956, and continued in session to and included the 27th day of March, 1956, judgment was rendered, at Waco, Texas, in said cause.

[fol. 138] IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS, AUSTIN DIVISION

[Title omitted]

COMPLAINT

Now come the plaintiffs, Dennis M. O'Connor and Katherine O'Connor, independent executors of the Estate of Thomas O'Connor, Deceased, and Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman, joined herein by her husband, D. H. Braman, and Thomas O'Connor, Jr., complaining of Frank Scofield, former Collector

of Internal Revenue for the First District of Texas, and allege:

I

This is an action to recover income taxes and interest erroneously assessed and collected by the Collector of Internal Revenue for the fiscal year ended November 30, 1948. Jurisdiction is based upon the existence of a federal question in that the case arises under a law providing for internal revenue.

[fol. 139]

II

Defendant owes plaintiffs the sum of $3,613,173.03 with interest at the rate of 6% per annum on account of income taxes erroneously assessed and collected and paid by plaintiffs, as will be shown more particularly hereinafter.

III

Plaintiffs are citizens of the United States and of the State of Texas, and reside in Victoria County, Texas.

IV

The defendant, Frank Scofield, was heretofore Collector of Internal Revenue for the First District of Texas and was the Collector to whom taxes sued for in this cause were paid, and is a resident of Travis County, Texas, which is in the Austin Division of the Western District of Texas.

V

Thomas O'Connor died testate in Victoria County, Texas, on December 5, 1946. Plaintiffs, Dennis M. O'Connor and Katherine O'Connor duly qualified as independent executors of the Estate of Thomas O'Connor, Deceased, and are now acting in such capacity. Plaintiffs, Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman, and Thomas O'Connor, Jr., are the sole heirs at law and devisees under the will of Thomas O'Connor, deceased. D. H. Braman is the husband of Mary O'Connor Braman.

VI

Within the time prescribed by law, to-wit, on February 14, 1949, planitiffs, Dennis M. O'Connor and Katherine

O'Connor, acting as executors of the Estate of Thomas O'Connor, Deceased, executed and filed with the defendant, as Collector of Internal Revenue, a fiduciary income tax return for said estate for the fiscal year ended November [fol. 140] 30, 1948, and paid the income tax shown to be due by said return, to-wit, $8,375,485.17.

VII

In the fiscal year ended November 30, 1948, the executors of the said estate had sold certain royalty interests in a transaction hereinafter more particularly described. The cash sum received from such sale was $9,990,350.00. At that time published rulings of the Treasury Department held that sales of this character should be reported for income tax purposes as ordinary income, subject to the allowance for statutory depletion. Being so advised, the executors of said estate reported said proceeds as ordinary income, deducting on said return the 27½% depletion, amounting to $2,747,346.25 and also deducting expenses attributable to said sale amounting to $10,990.00. The net income so reported on account of said sale was $7,232,013.75. The tax paid with respect to this item amounted to $5,620,717.14. Said tax was erroneously reported and paid. Plaintiffs allege that said sale of said limited royalty interest was the sale of a capital asset held for more than six months consisting of economic interests in oil in place in Refugio County, Texas, and which constituted a part of the assets of said estate. Said sale should have been reported as the sale of capital assets held for more than six months and should have been treated as long-term capital gain, in which event the tax thereon would have been $2,007,544.11. Demand is made upon the defendant for production at the trial of this cause of the original income tax return so filed by plaintiffs, as executors of said estate, for the fiscal year ended November 30, 1948.

[fol. 141] VIII

Thereafter, on February 11, 1952, and within three years from the date of the filing of the income tax return for the year in question, plaintiffs filed a timely and proper claim for refund in the amount of $3,621,263.73. Attached hereto, marked Exhibit "A", is a photostatic copy of the

retained copy of said claim for refund. Of the amount of the refund so claimed, $3,613,173.03 represents the difference between the amount of income taxes erroneously paid by said executors on the proceeds from the sale of said capital assets and the amount of income taxes which they should have paid as the result of such sale. The remaining amount of said claim involves an item not here in question. By registered letter dated March 12, 1953, the executors were notified by the Commissioner of Internal Revenue that of the amount sought by said claim for refund, only $7,571.26 was allowed. Said letter rejected the claim in full for the amount of $3,613,173.03, involving the tax paid in connection with the sale in question. This action is brought within the time prescribed by Section 3772(a)(2) of the 1939 Revenue Code and within the time prescribed by Section 6532 of the Internal Revenue Code of 1954. Demand is made upon the defendant to produce at the trial of this cause the original claim for refund filed by the executors.

IX

The facts in connection with the executors' sale of capital assets of said estate are as follows: Decedent, Thomas O'Connor, owned considerable property and it was evident that a large amount of cash would have to be accumulated in order to pay the Federal estate and State inheritance taxes which would be due from his estate. The Federal Es- [fol. 142] tate Tax return filed by said executors with defendant on January 5, 1948, showed that Federal estate taxes in the sum of $11,511,435.32 to be due from said estate. Of this amount, the executors paid defendant $8,911,435.32 on February 27, 1948, and requested the Commissioner of Internal Revenue to grant them an extension of time within which to pay the remaining $2,600,000.00. The requested extension was granted and the executors were given until March 5, 1949, to pay said sum. On August 25, 1948, the Commissioner of Internal Revenue assessed additional estate taxes against said estate in the amount of $1,844,605.90, which said amount was duly paid by plaintiffs on September 17, 1948. At that time State inheritance taxes in the sum of $2,159,450.48 were due. This was in addition to the sum of $1,105,602.46 previously paid to the State of Texas. By this time, the executors

had sold all of the stocks, bonds, cattle, horses, ranching equipment, and all other marketable personal property belonging to said estate. The remaining assets of said estate consisted of land and reserved royalty interests in the oil, gas and other minerals under same. Various plans to raise the necessary amount of money to discharge said Federal estate and State inheritance taxes were studied and considered by said executors and they finally decided to make an outright sale of certain reserved royalty interests in the oil in place under producing mineral properties owned by said estate and located in Refugio County, Texas. Accordingly, such sale was consummated on November 26, 1948, with D. E. Blackburn of Victoria, Texas, which involved the conveyance by general warranty deed to Blackburn by plaintiffs, as executors of said estate, and also individually along with the other devisees under the will of decedent, of certain fractional royalty interests in [fol. 143] the oil in place and to be produced from certain designated tracts of land owned by said estate and located in the Tomoconnor oil field in Refugio County, Texas. The consideration paid by D. E. Blackburn to the executors for the royalty interests so conveyed to him was $9,990,350.00 in cash. Attached to this Complaint as Exhibit "B" is a photostatic copy of a certified copy of the conveyance from the executors to Blackburn. The conveyance to Blackburn contained a provision to the effect that if, as and when Blackburn received a total sum of $10,000,000.00, together with interest thereon at the rate of four per centum (4%) per annum, (to be computed as provided therein) from oil produced from the interests conveyed to him, Blackburn's interest should terminate and the remainder should revert to the grantors named in said conveyance. The sale by the executors of these capital assets was complete and final. The payment of the consideration to them in cash was unconditional and irrevocable whether or not oil continued to be produced from the properties conveyed. There was no agreement or personal obligation on the part of plaintiffs or any of them to return all or any part of the consideration received by them from the purchaser under any condition, nor was there any guarantee by plaintiffs or any of them that purchaser would receive the sum stated out of production from the properties. Neither the plaintiffs nor

the decedent have ever engaged in the business of buying and selling oil, gas and mineral leases, or oil, gas and mineral royalties or any other form of interest in oil, gas or minerals. The basis for computing gain on the sale of such oil payment, being an aliquot part of the value at decedent's death of the royalties in question, was not less than $1,949,183.15. The proceeds from the sale of said oil payment were used to pay the remaining balance due on the [fol. 144] Federal estate tax, the balance due on the State inheritance tax and the income taxes arising from such sale.

X

The sale made by plaintiffs, as executors of said estate, was the sale of present interests in oil in place under the ground owned and held by decedent as a capital asset for more than six (6) months. Under applicable law, the proceeds of such sale of real property interests, not held for sale in the ordinary course of taxpayer's business, was taxable to decedent's estate in the manner and subject to the limitations provided by law for the taxation of long-term capital gains. The disallowance of plaintiffs' claim for refund and the taxation of such gains as ordinary income, subject to depletion, is wholly contrary to law, and has resulted in plaintiffs being illegally denied a refund of said income taxes and interest thereon.

Wherefore, premises considered, plaintiffs pray for judgment against the defendant for said income taxes erroneously paid in the sum of three million six hundred thirteen thousand, one hundred seventy-three & 03/100 dollars ($3,613,173.03), together with legal interest thereon from February 14, 1949, to the date of payment, and all costs herein expended, and for such other and further relief as may be proper herein.

F. C. Proctor, J. O. Jackson, Attorneys for Plaintiffs.

[fol. 145] Robertson, Jackson, Payne, Lancaster & Walker, 2800 Republic National Bank Building, Dallas 1, Texas. Stofer, Proctor, Houchins & Anderson, 411 Victoria Bank & Trust Company Building, Victoria, Texas.

(Here follows 1 Photolithograph, side folio 146)

(see next card)

Form 843
TREASURY DEPARTMENT
Internal Revenue Service
(Revised Feb. 1949)

EXHIBIT A TO COMPLAINT

CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

COLLECTOR'S STAMP
(Date received)
RECEIVED
FEB 19 1952
INT. REV.
DIST. REV.

- ☐ REFUND OF TAXES ILLEGALLY, ERRONEOUSLY, OR EXCESSIVELY COLLECTED.
- ☐ REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.
- ☐ ABATEMENT OF TAX ASSESSED (not applicable to estate, gift, or income taxes).

STATE OF Texas
COUNTY OF Victoria } ss:

TYPE OR PRINT

Name of taxpayer or purchaser of stamps Estate of Thos. O'Connor

Business address 408 Victoria Bank & Trust Bldg., Victoria, Texas
(Street) (City or town, postal zone number) (State)

Residence

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed First Texas
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 12-1, 1947, to 11-30, 1948
3. Character of assessment or tax Income Tax
4. Amount of assessment, $8,383,662.29; dates of payment
5. Date stamps were purchased from the Government
6. Amount to be refunded $3,621,263.73
7. Amount to be abated (not applicable to income, gift, or estate taxes) $
8. The time within which this claim may be legally filed expires, under section 322(b) of I. R. C. (Revenue Act or Internal Revenue Code) on February 15, 1952.

-10-

3. Character of assessment or tax Income Tax
4. Amount of assessment, $8,383,662.29; dates of payment
5. Date stamps were purchased from the Government
6. Amount to be refunded $3,621,263.73
7. Amount to be abated (not applicable to income, gift, or estate taxes) $
8. The time within which this claim may be legally filed expires, under section 322(b) of I. R. C. (Revenue Act or Internal Revenue Code) on February 15, 1952.

-10-

The deponent verily believes that this claim should be allowed for the following reasons:

Proceeds from sale of oil payments should have been treated as long-term capital gain realized on the sale of a capital asset.

In computing the tax liability the percentage limitations provided in Sections 12(9) and 12(c)(2) should not be applied to net long-term capital gains, but should be applied to ordinary income only; whereas the limitations provided in Sections 117(c)(2) should be applied to the long-term capital gain.

182136

(Attach letter-size sheets if space is not sufficient)

Subscribed and sworn to before me this 14th day of January, 1952

E. F. Bergner
(Signature of officer administering oath)

(Title)

Signed Jno. M. O'Connor Executor
Katherine E. Connor Executor
(SEE ATTACHED SHEET ALSO)

(SEE INSTRUCTIONS ON REVERSE)

16—18804-4

146 L. [illegible]

3-11

pany now running the oil from the above described premises, the grantee shall be entitled to receive only such oil as is run after twelve (12) midnight on November 30, 1948.

All the terms and conditions of this conveyance shall inure to and be binding upon the heirs, administrators, executors, successors and assigns to each of the parties hereto.

To have and to hold the royalty interest hereby conveyed unto the said D. E. Blackburn, his heirs and assigns, subject to the terms and provisions of said oil and gas leases and the terms and provisions of this conveyance, and the grantors, and each of them, do hereby bind themselves, their heirs, executors and administrators, to warrant and forever defend all and singular the said royalty interest unto the said D. E. Blackburn, his heirs and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof.

In Testimony whereof witness our hands this 26th day of November, 1948.

[fol. 157] Dennis M. O'Connor, Individually and as Independent Executor of the Estate of Thomas O'Connor, deceased.

(Int. Rev. Stamps Attached and Cancelled $10,990.00)

Katherine O'Connor, Individually and as Independent Executrix of the Estate of Thomas O'Connor, deceased. Mary O'Connor Braman, D. H. Braman, Thomas V. O'Connor.

STATE OF TEXAS,
County of Victoria:

Before me, the undersigned authority, on this day personally appeared Dennis M. O'Connor, Independent Executor of the Estate of Thomas O'Connor, deceased, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed both individually and in the representative capacity therein stated.

Given under my hand and seal of office this 26th day of November, 1948.

Louise Ernst, Notary Public in and for Victoria County, Texas. (Seal.)

STATE OF TEXAS,
County of Victoria:

Before me, the undersigned authority, on this day per-
[fol. 158] sonally appeared Katherine O'Connor, a feme sole, Independent Executrix of the Estate of Thomas O'Connor, deceased, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that she executed the same for the purposes and consideration therein expressed both individually and in the representative capacity therein stated.

Given under my hand and seal of office this 26th day of November, 1948.

Louise Ernst, Notary Public in and for Victoria County, Texas. (Seal.)

STATE OF TEXAS,
County of Victoria:

Before me, the undersigned authority, on this day personally appeared D. H. Braman, and Mary O'Connor Braman, husband and wife, both known to me to be the persons whose names are subscribed to the foregoing instrument, and acknowledged to me that they each executed the same for the purposes and consideration therein expressed, and the said Mary O'Connor Braman, wife of the said D. H. Braman, having been examined by me privily and apart from her husband, and having the same fully explained to her, she, the said Mary O'Connor Braman, acknowledged such instrument to be her fact and deed, and declared that she had willingly signed the same for the purposes and consideration therein expressed, and that she did not wish to retract it.

Given under my hand and seal of office this 26th day of November, 1948.

[fol. 159] Louise Ernst, Notary Public in and for Victoria County, Texas. (Seal.)

[fol. 147] We, Katherine O'Connor, Dennis M. O'Connor, Mary O'Connor Braman, and Tom O'Connor, Jr., each individually join in the foregoing claim as heirs at law of the said Thomas O'Connor, deceased.

In testimony whereof witness our hands this 14th day of January, 1952.

Katherine O'Connor, Dennis M. O'Connor, Mary O'Connor Braman, Tom O'Connor, Jr.

[fol. 148]

Estate of Thomas O'Connor

Claim for Refund

Fiscal Year Ended November 30, 1948

		Ordinary Income	Capital Gain
Net income per R A R dated 11-20-51		10,757,837.19	29,177.98
Proceeds from sale of oil payment erroneously treated as ordinary income (Net of Depletion)		(7,232,013.75)	
Long-term capital gain on sale of oil payment:			
Sales price	9,990,350.00		
Expense of Sale	10,990.00		
Net Sales Price	9,979,360.00		
Basis (Computed below)	1,949,183.55		
Profit on Sale	8,030,176.45		
Long-term capital gain			4,015,088.23
Net Income Corrected		3,525,823.44	4,044,266.21

Basis in Oil Payment Sold:

	Barrels	Basis Per Estate Tax Report Dated 6-18-48*	Total
Thos. O'Connor "A" Lease	365,785	.537205	196,501.53
Thos. O'Connor "C" Lease	788,022	.378308	298,115.03
Nordan and Morris Lease	344,236	.517045	177,985.50
L. A. Nordan "A" Lease	588,676	.544628	320,609.43
L. A. Nordan "B" Lease	.....	.....	.....
Copano "A" Lease	267,265	.575576	153,831.32
Copano "B" Lease	688,317	.728326	501,319.17
Copano "E" Lease	987,683	.304573	300,821.57
	4,029.984		1,949,183.55

* See also R A R dated 7-24-50, covering fiscal year ended 11-30-47.

STATE OF TEXAS,
County of Victoria:

Before me, the undersigned authority, on this day personally appeared Thomas V. O'Connor, known to me to be the person whose name is subscribed to the foregoing instrument, and ackpowledged to me that he executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this 26th day of November, 1948.

Louise Ernst, Notary Public in and for Victoria County, Texas. (Seal.)

Filed for record the 26th day of November, A. D., 1948, at 5:00 o'clock P. M.

Recorded this the 1st day of December, A. D., 1948, at 9:45 o'clock A. M.

Bettie Adkins, Clerk, County Court, Refugio County, Texas, by Jewel Berry, Deputy.

[fol. 160] THE STATE OF TEXAS,
County of Refugio:

I, Bettie Adkins, Clerk of the County Court of Refugio County, Texas, do hereby certify that the above and foregoing is a true and correct copy of Royalty Deed from Dennis M. O'Connor, et al. to D. E. Blackburn, as the same appears of record in Volume 71, Pages 208-211, Deed Records of Refugio County, Texas.

To Certify, Witness my hand and seal of office at office in Refugio, Texas, this the 3rd day of February, A. D., 1955.

Bettie Adkins, Clerk, County Court, Refugio County, Texas, by Catherine Talman, Deputy. (Seal.)

Filed: March 4, 1955.

[fol. 161] IN UNITED STATES DISTRICT COURT

ORDER EXTENDING TIME FOR FILING ANSWER—May 4, 1955

On motion of the defendant in the above entitled and numbered cause,

[fol. 149] Estate of Thomas O'Connor

Computation of Tax

Fiscal Year Ended November 30, 1948

Computation at 1947 Rates:	
Net Income per schedule:	
Ordinary Net Income	3,525,823.44
Long-Term Capital Gain	4,044,266.21
Net Income	7,570,089.65
Less: Exemption	500.00
Balance	7,569,589.65
Combined tentative normal tax and surtax	6,863,146.58
Less: 5% of tentative tax	343,157.33
Combined normal tax and surtax	6,519,989.25
Alternative Tax:	
Net Income	7,570,089.65
Less: Long-Term Capital Gain	4,044,266.21
Ordinary Net Income	3,525,823.44
Less: Exemption	500.00
Balance	3,525,323.44
Combined tentative normal tax and surtax	3,182,864.33
Less: 5%	159,143.22
Balance	3,023,721.11
Limited to 85½% of $3,525,823.44	3,014,579.04
Tax on Capital Gain	2,022,133.11
Alternative Tax	5,036,712.15
Tax Assessable under 1947 Law	5,036,712.15

It is ordered that the time for filing answer in this cause be, and the same is hereby, extended for the period of sixty (60) days from May 13, 1955.

Entered this the 4 day of May, A. D. 1955, at San Antonio, Texas.

Ben H. Rice, Jr., United States District Judge.

[fol. 162] In United States District Court

Answer—Filed May 11, 1955

Now comes the defendant by and through his attorney of record, Russell B. Wine, United States Attorney in and for the Western District of Texas, and for his answer would respectfully show unto the Court as follows:

I

Defendant denies the allegations contained in paragraph 1 of plaintiffs' complaint except it is admitted that this law suit is brought by the plaintiffs to recover income taxes and interest for the fiscal year ended November 30, 1948; it is further admitted that this Court has jurisdiction of the case.

II

Defendant denies the allegations contained in paragraph 2 of plaintiffs' complaint.

III

Defendant admits the allegations contained in paragraph 3 of plaintiffs' complaint.

IV

Defendant admits the allegations contained in paragraph 4 of plaintiffs' complaint.

V

Defendant admits the allegations contained in paragraph 5 of plaintiffs' complaint.

[fol. 163]

VI

Defendant admits the allegations contained in paragraph 6 of plaintiffs' complaint.

[fol. 150] Estate of Thomas O'Connor

Computation of Tax
(Continued)

Computation at 1948 Rates:	
Net Income	7,570,089.65
Less: Exemption	600.00
Balance	7,569,489.65
Combined Tentative Normal Tax and Surtax	6,863,055.58
Less: $12,020 plus 9.75% of $6,763,055.58	671,417.92
Balance	6,191,637.66
Alternative Tax:	
Net Income Less Exemption	7,569,489.65
Less: Long-Term Capital Gain	4,044,266.21
Balance	3,525,823.44
Combined Tentative Normal Tax and Surtax	3,183,319.33
Less: $12,020 plus 9.75% of $3,083,319.33	312,643.63
Balance	2,870,675.70
Limited to 77% of $3,525,823.44	2,714,884.05
50% of Long-Term Capital Gain	2,022,133.11
Alternative Tax	4,737,017.16
Tax Assessable Under 1948 Law	4,737,017.16
Tax Assessable and Refund Claimed:	
31/366 of $5,036,712.15	426,606.75
335/366 of $4,737,017.16	4,335,791.81
Total Tax Assessable	4,762,398.56
Tax Previously Assessed	8,383,662.29
Refund Claimed	3,621,263.73

VII

Defendant denies the allegations contained in paragraph 7 of plaintiffs' complaint except it is admitted that in the income tax return for the fiscal year ended November 30, 1948, plaintiffs reported a transaction in respect of certain oil payment rights and in respect of such transaction included in the gross income for the fiscal year ended November 30, 1948, the amount of $9,990,350; it is further admitted that from this amount which was reported as ordinary income there was deducted on said tax return. the 27½% depletion which amounted to $2,747,346.25.

VIII

Defendant denies the allegations contained in paragraph 8 of plaintiffs' complaint except it is admitted that on September 13, 1952, plaintiffs filed a claim for refund in the amount of $3,621,263.73; it is further admitted that attached to the complaint as Exhibit A is a photostat copy of said claim for refund, but each and every allegation and conclusion contained in said claim is specifically denied; it is further admitted that by rejection letter dated March 12, 1953, the executors were notified by the Commissioner of Internal Revenue that the said claim for refund was rejected in full for the amount of $3,613,173.03.

IX

Defendant is without knowledge or information sufficient [fol. 164] to form a belief as to the truth of the allegations contained in paragraph 9 of the complaint except it is denied that a sale of certain royalty interests in Refugio County, Texas, was made; it is admitted that $9,990,350 was received by plaintiffs in respect of a transaction entered into with one B. E. Blackburn; it is further admitted that attached to the plaintiffs' complaint as Exhibit B is a purported photostat copy of a purported conveyance from the plaintiffs to Blackburn; it is further denied that the plaintiffs and the decedent have never engaged in the business of buying and selling oil, gas, and mineral leases, or oil, gas, and mineral royalties.

[fol. 151] February 11, 1952

Mr. Clyde Dabbs, Deputy Collector,
Bureau of Internal Revenue,
Victoria, Texas.

Dear Mr. Dabbs:

Attached hereto are claims for refunds, Forms 843, executed by the following individuals, covering the years and for the amounts shown:

Mrs. Kate S. O'Connor—Cal. 1948	$11,303.68
Mrs. Kate S. O'Connor—Cal. 1949	$11,848.49
Dennis O'Connor & Wife (Dorothy H.)—Cal. 1948	$17,016.01
Dennis O'Connor & Wife (Dorothy H.)—Cal. 1949	$15,610.97
Tom O'Connor, Jr. & Wife (Junie B.)—Cal. 1948	$17,016.03
Tom O'Connor, Jr. & Wife (Junie B.)—Cal. 1949	$15,610.95
D. H. Braman & Wife (Mary O'Connor)—Cal. 1948	$17,016.01
D. H. Braman & Wife (Mary O'Connor)—Cal. 1949	$15,610.95
Estate of Thos. O'Connor—F. Y. 11-30-48	$3,621,263.73

Please acknowledge receipt of the inclosed claims by signing the attached copy of this letter.

Yours truly, Melvin L. Roloff.

MLR/ge

Received by Clyde A. Dabbs, February 11, 1952.

[fol. 152] Exhibit "B" to Complaint

State of Texas,
County of Refugio:

Know all men by these presents: That we, Dennis M. O'Connor, of Refugio County, Texas, individually and as independent executor of the estate of Thomas O'Connor, deceased, Katherine O'Connor, a feme sole, individually and as independent executrix of said estate, Mary O'Connor Braman, joined herein by her husband D. H. Braman, and Thomas V. O'Connor, all of Victoria County, Texas, for and in consideration of the sum of Ten Dollars ($10.00) and other valuable considerations to us in hand paid by D. E. Blackburn, of Victoria County, Texas, the receipt of which is hereby acknowledged and confessed, have granted,

X

Defendant denies the allegations contained in paragraph 10 of plaintiffs' complaint.

Wherefore, premises considered, defendant prays for judgment against the plaintiffs and, asks that the complaint be dismissed with prejudice, and for such other and further relief to which he may be entitled.

Russell B. Wine, United States Attorney.

[fol. 165] In United States District Court

Stipulation of Facts—Filed November 4, 1955

The parties to the above-entitled action, through their respective attorneys, do stipulate and agree that the facts hereinafter stated are true and correct and that this stipulation may be offered in evidence without objection, subject to the right of either of the parties to this action to introduce other and additional evidence not inconsistent with the facts herein stipulated.

I

Thomas O'Connor died testate in Victoria County, Texas, on December 5, 1946. Plaintiffs, Dennis M. O'Connor and Katherine O'Connor duly qualified as independent executors of the Estate of Thomas O'Connor, Deceased, and are now acting in such capacity. Plaintiffs, Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman, and Thomas O'Connor, Jr. are the sole heirs at law and devisees under the will of Thomas O'Connor, deceased. D. H. Braman is the husband of Mary O'Connor Braman.

II

Attached hereto as Exhibit 1 is a photostatic copy of the instrument executed by plaintiffs as executors of the Estate of Thomas O'Connor, Deceased, and also individually, as devisees under the Will of Thomas O'Connor, which instrument evidences a transaction with D. E. Blackburn of Victoria, Texas. The instrument was delivered to D. E.

bargained, sold, transferred, assigned and conveyed, and by these presents do grant, bargain, sell, transfer, assign and convey unto the said D. E. Blackburn, the following described properties situated in Refugio County, Texas.

1. One-sixteenth (1/16) royalty interest (being 1/16 of 8/8) of all oil produced, saved and marketed from that certain 4,000 acre tract of land described in that certain Designation Agreement executed by Quintana Petroleum Company, dated March 20, 1934, and recorded in Vol. 27 at page 513 of the Deed Records of Refugio County, Texas, to which said Agreement and the record thereof reference is here made for a more complete description of said 4,000 acre tract of land; said tract of land is subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to Quintana Petroleum Com-
[fol. 153] pany, as lessee, dated January 19, 1934, and recorded in Vol. 21 at page 17 of the Deed Records of Refugio County, Texas, and known as Quintana "A" Lease.

2. One-fourth (¼) royalty interest (being ¼ of 8/8) of all oil produced, saved and marketed from that certain 1076.26 acre tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to Quintana Petroleum Cospany, as lessee, dated April 22, 1935, and recorded in Vol. 33 on pages 343-348 of the Deed Records of Refugio County, Texas, and known as Quintana "C" Lease.

3. One-half (½) royalty interest (being ½ of 8/8) of all oil produced, saved and marketed from that certain 200 acre tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to Copano Oil Company, as lessee, dated April 20, 1938, and recorded in Vol. 39 on pages 505-509 of the Deed Records of Refugio County, Texas, and known as Copano "A" Lease.

4. Three-eighths (⅜) royalty interest (being ⅜ of 8/8) of all oil produced, saved and marketed from that certain 670 acre tract of land, 410 acres of which is described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to Copano Oil Company, as lessee, dated July 25, 1938, and recorded in Vol. 40 on pages 570-575 of the Deed Records of Refugio County, Texas; 160 acres of which is described in and subject to

that certain Supplemental Lease Contract executed by Thomas O'Connor, as lessor, to Copano Oil Company, as lessee, dated September 26, 1938, and recorded in Vol. 41 on pages 237-239 of the Deed Records of said County; the remaining 100 acres of which is described in and subject to [fol. 154] that certain Supplemental Lease Contract executed by Thomas O'Connor, as lessor, to Copano Oil Company, as lessee, dated November 5, 1938, and recorded in Vol. 42 on pages 55-57 of the Deed Records of said County; said 670 acre tract being known as Copano "B" Lease.

5. One-fourth (¼) royalty interest (being ¼ of 8/8) of all oil, produced, saved and marketed from that certain 1,754.86 acre tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to Copano Oil Company, as lessee, dated July 31, 1946, and recorded in Vol. 61 on pages 216-220 of the Deed Records of Refugio County, Texas; said 1,754.86 acre tract being known as Copano "E" Lease.

6. One-half (½) royalty interest (being ½ of 8/8) of all oil produced, saved and marketed from that certain 234.52 acre tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to L. A. Nordan and John Morris, as lessees, dated April 28, 1937, and recorded in Vol. 38 on pages 219-223 of the Deed Records of Refugio County, Texas, and known as Nordan and Morris Lease.

7. One-half (½) royalty interest (being ½ of 8/8) of all oil produced, saved and marketed from that certain 80 acre tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to L. A. Nordan, as lessee, dated August 11, 1937, and recorded in Vol. 38 on pages 226 et seq. of the Deed Records of Refugio County, Texas, and known as Nordan "A" Lease.

8. One-half (½) royalty interest (being ½ of 8/8) of all oil produced, saved and marketed from that certain 310 acre [fol. 155] tract of land described in and subject to that certain oil, gas and mineral lease executed by Thomas O'Connor, as lessor, to L. A. Nordan, as lessee, dated December 15, 1937, and recorded in Vol. 38 on pages 270-274 of the Deed Records of Refugio County, Texas, and known as Nordan "B" Lease.

Blackburn and duly recorded in the Deed Records of Refugio County, Texas.

III

D. E. Blackburn paid to the plaintiffs in the transaction [fol. 166] on the date of the delivery of the instrument (Exhibit 1) the sum of $9,990,350. The transaction evidenced by Exhibit 1 was carried out in accordance with its terms. Blackburn received the money from the companies running the oil from the properties pursuant to transfer orders executed by plaintiffs to the respective pipeline companies. Copies of the transfer orders are attached as Exhibit 2 and made a part hereof.

IV

Within the time prescribed by law, to-wit, on February 14, 1949, plaintiffs, Dennis M. O'Connor and Katherine O'Connor, acting as executors of the Estate of Thomas O'Connor, Deceased, executed and filed with the defendant as Collector of Internal Revenue, the fiduciary income tax return for the estate for the fiscal year ended November 30, 1948, and paid the tax shown to be due thereon, to-wit $8,375,485.17. In this return, in accordance with published rulings of the Treasury Department, the executors of the estate reported the proceeds from the transaction above described in the amount of $9,990,350.00 as ordinary income, deducting, however, on said income tax return the 27½% depletion amounting to $2,747,346.25 and also deducting expenses attributable to said sale amounting to $10,990.00. The net income so reported on account of said transaction was $7,232.013.75.

V

Thereafter, on February 13, 1952, and within three years from the date of the filing of the income tax return for the year in question, plaintiffs filed a timely claim for refund in the amount of $3,621,263.73. Attached hereto, marked Exhibit 3, is a photostatic copy of the said claim for [fol. 167] refund. This copy is a true and correct copy of the original claim filed with the Collector of Internal Revenue.

VI

As a result of the claim for refund an overassessment in the amount of $8,950.26 plus interest of $435.13 was re-

funded on schedule dated February 2, 1953. Of the $8,950.26 refunded, $7,571.26 consisted of overpayment in tax, and the remaining $1,379 consisted of deficiency interest. By registered letter dated March 12, 1953 the executors were notified that the claim for refund was rejected to the extent not previously allowed.

VII

If the gain from the transaction in question is properly taxable as income from the sale of a capital asset held for more than six months, and not as ordinary income, the basis for computing such gain is $1,925,105.81.

VIII

Exhibit 1 provided that, after the properties described therein had produced to Blackburn the sum of $10,000,000.00 (with interest as cumputed thereon at 4% per annum), the properties would revert to the grantors. The aforesaid amount (together with interest) was duly received by Blackburn from said properties during the period beginning January 28, 1949 and ending December 24, 1951. Upon receipt of this amount, Blackburn, pursuant to the provisions of the instrument, executed a release in favor of the estate, which said release was duly recorded in the Deed Records of Refugio County, Texas. Attached hereto marked Exhibit 4, is a copy of said release executed by Blackburn.

[fol. 168] IX

Attached hereto, marked Exhibit 5, is a schedule showing the number of barrels produced from the properties, from and after the transaction in question; the amount of dollars received by Blackburn in each of the years, 1949, 1950 and 1951 and the average price received for each barrel of oil so produced. At the date of the transaction aforesaid, in accordance with information then available to the executors of the estate and to Blackburn, and based upon prices then being received for oil, the parties had reason to believe that the properties described in the instrument had a value substantially in excess of the amount paid by Blackburn and that the properties described in said instrument would produce, over their life, sums substantially in excess of the $10,000,000.00 figure referred to in the in-

The Royalty Interests hereinabove described and conveyed shall terminate, and the title thereto shall revert and re-vest in the grantors herein whenever there shall have been delivered to the credit of the grantee an amount of oil, if, as and when produced, free of all costs, which, valued at the price paid therefor by the purchasers of said oil at the time when sold and delivered off the premises, shall equal in value the sum of Ten Million Dollars ($10,000,00.00) together with interest computed as hereinafter provided. Said interest shall be computed at the rate of four per centum (4%) per annum from the date hereof on the unrealized balance of said Ten Million Dollar ($10,000,000.00) oil payment remaining after each month's credit of the proceeds received from the sale of said oil is made. Said monthly credit shall be made as of the date grantee receives payment from the pipe line company or companies purchasing said oil, and shall be the net amount remaining after first deducting from said payments an amount equal to interest at the rate of four per centum (4%) per annum on the unrealized balance of said $10,000,00.00 oil payment computed over the period intervening since the previous credit was made.

It is expressly provided that the royalty interest herein conveyed shall be free and clear of all operating and production costs, and free and clear of all taxes (except income taxes, if any, payable by grantee), and that grantee shall be entitled ultimately to receive the net amount of oil herein conveyed without deduction for said taxes, nevertheless, [fol. 156] in remitting the monthly proceeds realized from the sale of oil the pipe line company or companies receiving such oil shall be authorized to deduct current gross production taxes and regulation pipe line taxes from such proceeds.

It is expressly agreed that this conveyance is made subject to the terms and provisions of all existing oil and gas leases covering the above described premises, and that except as to the right to receive the royalties herein conveyed grantors reserve and retain all the rights, powers and privileges, express or implied, now owned and possessed by them as lessors in such leases.

It is agreed that while this instrument shall be effective as of this date, yet, for the convenience of the pipe line com-

strument, together with interest as computed thereon at 4% per annum. Attached hereto, marked Exhibit 6, is a schedule showing the barrels produced and the volume and amount received from each particular property described in the instrument during the years 1944 to 1948, inclusive. This schedule also shows the average price received per barrel from said described properties. On November 26, 1948, based upon agreements reached with Government Engineers in connection with settlement of the estate tax liability of Thomas O'Connor, deceased, it is estimated that there were approximately 23,150,000 barrels of recoverable oil in place under the properties in question; and that after Blackburn had recovered the Ten Million Dollars ($10,000,000.00) and interest as aforesaid, it is estimated that there were approximately 19,150,000 barrels of recoverable oil in place under said properties.

[fol. 169]

X

The amount received by the estate from D. E. Blackburn was not used for the development of this or any other oil property, nor was said sum pledged, earmarked or agreed to be used in connection with any such development.

XI

Attached hereto, marked Exhibit 7, is a photostatic copy of the fiduciary income tax return filed by the executors of the estate for the fiscal year ending November 30, 1948.

F. C. Proctor, J. Paul Jackson, Attorneys for Plaintiffs. Russel B. Wine, United States Attorney, by Lonny J. Zwiener, Asst. U. S. Attorney.

(Note: Exhibits Omitted.)

[fol. 170] IN UNITED STATES DISTRICT COURT

Court Reporter's Transcript

APPEARANCES:

Mr. Jackson, Attorney for Plaintiffs.
Messrs. Mehaffy and Stroud, Attorneys for Defendant.

Morning Session

Friday, November 4th, 1955

The Court: Are you ready to proceed, gentlemen?
Mr. Mehaffy: Yes, sir.
The Court: Is the rule invoked?
Mr. Jackson: We don't care to.
The Court: Then they may resume their seats when they are sworn.

(All witnesses present in courtroom were then sworn by the Clerk.)

The Court: All right. You may go ahead.

OPENING STATEMENT

Mr. Jackson: If the Court please, this is an income tax case involving the return for the year 1951. It simply—the issue involved is simply whether or not the sale by the O'Connor Estate of certain producing papers, or certain [fol. 171] royalties, of a limited nature, royalties, which upon the payment of some ten million dollars with interest thereon at four per cent, after which time it would revert back to the Estate, whether that sale was the sale of a capital asset subject to capital gains treatment, or whether it is ordinary income to the Estate.

And, very briefly, the facts are that Ton O'Connor died in 1947 leaving a will, leaving a widow and three heirs; two sons and a daughter. The daughter is married. And those parties are all before the Court as plaintiffs here.

His will appointed his son, Dennis O'Connor, and his wife, Katherine O'Connor, independent executors of his Estate. And among the assets of the Estate were certain royalties that Tom O'Connor owned at the time of his death.

Two years after his death, in order to pay the unpaid balance owed on a very large Federal Estate Tax, and the very large balance due the State of Texas on Inheritance Taxes, the executors of the Estate proceeded, by instruments which will be stipulated, to sell to one D. E. Blackburn this royalty for $9,990,000.00 in cash; this royalty, under the instrument, to be transferred to Blackburn until such time Blackburn from the proceeds thereof had derived the ten million dollars plus interest on such ten million dollars at the declining rate of four per cent per annum. Blackburn paid the executors of the Estate ten million dollars, which funds were used to pay unpaid taxes.
[fol. 172] The question is simply whether that sale gives rise to capital gains treatment, or to ordinary income treatment.

Pursuant to the ruling of the Bureau at the time, the executors of the Estate paid the taxes in accordance with the then existing bureau ruling; they reported the amount received at ordinary income rates and paid the taxes at the ordinary rate. Thereafter, and in due time, they filed claims for refund, asking recovery of part of the payment on the ground that they should have been taxed on capital gains rates. That claim was in due course rejected by the Commissioner, and this suit ensued. I might say that in connection with the sale to Blackburn, the evidence will show that the sale was a bona fide sale, that the purpose of the sale was to raise money to pay taxes, and there was no agreement with Blackburn pertaining to guaranty of payment; it was a sale of certain mineral interests in the properties in Texas. If the Court please, we have stipulated most of the facts. We will call two witnesses somewhat later.

The Court: Is the stipulation reduced to writing?

Mr. Jackson: The stipulation has been reduced.

The Court: Mr. Mehaffy.

Opening Statement

Mr. Mehaffy: If it please the Court, Mr. Ethan B. Stroud and I are attorneys for the Tax Division of the Department of Justice, we are representing the Government in this case. Mr. Jackson has made a fair statement of the facts, with one thing included, in the stipulation, that no part of the

funds was pledged or used or agreed to be used for the development of their or any other oil properties. The issue is, and Mr. Jackson's statement also, whether or not the gains from the transaction is entitled to capital gains treatment as a sale of capital assets, assets held for more [fol. 173] than nine months, or whether it is taxable as ordinary income as it was reported on the original fiduciary return for the Estate. The Government's position is simply that in the first place there was no sale of the capital assets; there was an assignment of income only; and, second, that if the property is of such character that it can be broken into segments, and the segments having the characteristics of the whole, then it could be held to be a sale of a part of the property itself. Still it is our position that the assignment or the transfer was of such insubstantial nature, so far as it refers to the transaction in itself, that there is no sale of capital assets. In other words, ten million dollars plus four per cent interest, computed according to the terms of the instrument, made out in this case at 36 months, and our position is that, and the decision in other cases, that it is within the line of cases holding that it is simply an allotment to another person of income, which had it been received by the Estate, would have been taxable as ordinary income.

Mr. Jackson: Your Honor, at this time, and before calling witnesses, I would like to have permission to file as part of the record the agreed stipulation of the parties in this case. I think it might help the Court if I might run over the basic points in the stipulation. It is agreed, first, that Thomas O'Connor died testate in Victoria County in 1946; and that the plaintiffs here, Dennis O'Connor and Katherine O'Connor, are duly qualified as independent executors and that they are now acting in that capacity; that the plaintiffs, Dennis O'Connor and Katherine O'Connor and Mary O'Connor Breland and Thomas O'Connor are the sole heirs of Tom O'Connor, deceased, and that T. H. Breland is the husband of Mary O'Connor Breland. Now, we have attached here as Exhibit No. 1 a photostatic copy of the [fol. 174] instrument which is in question. This is the instrument executed by the plaintiffs as executors of the Estate and independently as heirs of the Estate, which instrument is a contract with Blackburn for and in consider-

ation of the sum of ten million dollars and other valuable considerations in hand paid by Blackburn, receipt of which is hereby acknowledged, have granted, warranted, sold, transferred, assigned, and by these presents do grant, warrant, transfer, assign, and convey to Blackburn the following described properties. The properties are set out. In Refugio County, Texas. It goes on to define by description certain royalty interests, the one-sixteenth of eight-eight-s in one instance, one-fourth of eight-eighths in another, in certain described lands, which I need not go into at this time. There are three pages of those descriptions and definate royalty interests. It then provides that the royalty interests hereinabove described and conveyed shall terminate and title thereto shall be reverted and reinvested in the grantors whenever there shall have been delivered to the credit of the grantee here in the amount of oil herein set forth, and produced free of all costs, or the value of the price therefor, at the time when sold and delivered off the premises, shall equal the value of ten million dollars together with interest compounded at four per cent per annum, and after providing interest on the unrealized balance of said ten million dollars remaining after each month's dividends, or proceeds, from said oil is received—as of the date grantee receives payment from the pipeline company or person purchasing said oil, and shall be the net amount remaining after first deducting from said payment an amount equal to interest at the rate of four per cent per annum on the unrealized balance of ten million dollars oil payment over the period computed intervening between the time of expiration and the time previous credits were made. Then it provides [fol. 175] that if, as and when the oil payment has been concluded, that when the assignee has received the full amount, this property will revert back, or the assignment will be reconveyed, the property, to the grantors. It is signed and acknowledged, and was duly recorded in the Deed Records of Refugio County. Now, it is stipulated in connection with this transaction D. E. Blackburn paid to the plaintiffs on the date of the delivery of the instrument, the sum of nine million nine hundred thirty thousand three hundred fifty dollars, and it is further stipulated that the transaction was carried out in accordance with the terms: Blackburn received the money from the pipeline company

running the oil from the property pursuant to the transfer orders executed by the plaintiffs to the particular pipeline companies, and copies of those transfer orders are also attached as exhibits to this stipulation. It is further agreed that within the time prescribed by law, that is on February 14th, the plaintiffs, as executors and as individuals, filed with the defendant collector of Internal Revenue a deficiency return for the Estate for the fiscal year ending November 30, 1948, and paid taxes thereon shown to be due, to-wit: One million three hundred seventy-five thousand dollars. This return, it is agreed, in accordance with the then published rules of the Treasurary Department, the executors of said Estate reported this transaction described above in the sum of nine million nine hundred ninety thousand dollars as ordinary income, deducting from that amount the deficiency in the amount of twenty-seven and a half percent, in the amount of two million two hundred seventy thousand dollars, and they also deducted expenses attributable to the sale in the sum of ten thousand nine hundred ninety dollars, and the net income on the report on account of those transactions, therefore, was seven million two hundred thirty-two thousand thirteen dollars [fol. 176] and seventy five cents. It is agreed thereafter that on February 1, 1952, and within three years from the date of filing of the return they filed a timely claim for refund in the amount of three million six hundred thousand dollars plus. Attached hereto as a part of this stipulation as Exhibit No. 3 is a photostatic copy of the refund claim, a correct copy of the claim, as filed before the Collector. As a result of the claim, an over assessment of eighty nine hundred fifty dollars, plus interest of thirty-five hundred dollars, was refunded on February 2, 1951. And I might say that was wholly unrelated to the issue in this transaction. And by registered mail on March 12, 1953, the Director notified the plaintiffs that the balance of the claim was rejected to the extent not previously allowed. Now, it is further agreed, if the Court please, that if the gains from the transaction were properly taxable as income from the sale as capital assets held for more than six months, then, and not as ordinary income, the basis for computing the gain is one million nine hundred twenty-five thousand five hundred five dollars and five cents; that is on the basis of

capital gains treatment. It is further agreed that under this transaction, and under the instrument of transfer, Exhibit No. 1, that that instrument provides that after the property described had produced to Blackburn the sum of ten million dollars with interest thereon at four percent per annum the property would revert to the grantors; that the aforesaid amount, ten million dollars, taken on a declining rate, with four per cent per annum, received by Blackburn from said properties during a period beginning January 28, 1949, and ending December 24th, 1951, which you will recall is three years, or thirty-six months; upon receipt of the final amount by Blackburn, and in pursuance to the provisions of the transfer to him, he executed a [fol. 177] release in favor of the Estate which said—which release is duly recorded in the Deed Books of Refugio County, and attached is a copy of that release, or transfer, by Blackburn. Now, we also attach as an exhibit to the stipulation Exhibit No. 5, showing the schedule of number of barrels produced from the properties there after the transaction in question, and during the three year period of the so-called payout. This schedule also shows the amount of dollars received by Blackburn in each of the years 1949, 1950 and 1951, and the average price paid per barrel so produced. It is agreed further that at the date of the transaction aforesaid, and in accordance with the information available to the transferrors, the executors, and to Blackburn, and based upon prices then being received for oil, the parties had reason to believe that the properties described in the instrument had a value substantially in excess of the amount paid by Blackburn, and that the properties described in the instrument had a value substantially in excess of the amount paid by Blackburn, and that the properties so described in said instrument would produce over their lives sums substantially in excess of the ten million dollars referred to in the instrument, together with interest thereon at four per cent. Attached is exhibit No. 6, which is a schedule showing the barrels produced for the period 1944 to 1948, inclusive, that is the period preceding the transfer, showing the barrels, the volume, and the amount received from the particular properties which were described in and made the subject of instrument of transfer. The schedule also shows the average price received per barrel from the individual properties. On November 26, 1948,

which is the date of the transfer, it is agreed that, based upon agreements reached with the Government engineers in connection with the settlement of Federal Estate Tax liability of the Estate of Thomas O'Connor, deceased, it [fol. 178] is estimated that on the date of the transfer there were approximately twenty-three million one hundred fifty thousand barrels of oil, of recoverable oil, in place under the properties in question, and that after Blackburn had recovered the ten million dollars and interest, as aforesaid, it was estimated there was approximately nineteen million one hundred fifty thousand barrels of recoverable oil in place under said properties. Now, it is further agreed, as Mr. Mehaffy said, that the amount received by the Estate from Blackburn was not used in the development of oil properties of theirs, or any other oil property, nor were the said sums pledged or ear-marked or agreed to be used in connection with any such oil development. We also attach as an exhibit a photostatic copy of income tax returns filed for the years in question. Now, then, Your Honor, that is our stipulation.

Now, we have two witnesses to supplement this to a slight degree dealing with the nature of these transactions. First I would call Mr. Dennis O'Connor.

Dennis O'Connor, a witness called by the plaintiffs, having been duly sworn testified as follows:

Direct examination.

Questions by Mr. Jackson:

Q. Your name is Dennis O'Connor?

A. Yes, sir.

Q. And you are the son and heir of Tom O'Connor, deceased?

A. Yes.

Q. And you are the independent executor of the estate? [fol. 179] A. Yes.

Q. You act as an independent executor with Katherine O'Connor, your mother?

A. That is right.

Q. Did you negotiate this transaction that we referred to in the stipulation between yourself and Mr. Blackburn?

A. Yes, sir.

Q. Will you tell us your understanding of that transaction, precisely what it was?

A. Well, my understanding was that on the assignment to him of certain royalties that he was to pay me this figure, which was approximately $10,000,000.00, and that when he had recovered $10,000,000.00, plus interest at four percent on the declining balance, this property would revert to the estate, to the heirs.

Q. Was it your understanding that you conveyed to him the estate's entire interest in the described royalties?

M . Mehaffy: Now, Your Honor, I object to that. The instrument speaks for itself, and what Mr. O'Connor's understanding of the meaning of it is would hardly be material.

The Court: I believe I will carry your objection along and not sustain the objection now.

Mr. Jackson: Your Honor, it is well known, of course, that sometimes an instrument on its face may be construed as giving the parties some interest in——

The Court: That is true.

[fol. 180] Mr. Jackson: I would like to have him give his theory whether this was a transfer and not a mortgage.

The Witness: That was my understanding.

By Mr. Jackson:

Q. It was your understanding that you were transferring——

A. I was selling to him a certain amount of oil.

Q. In place?

A. In place.

Q. Now, the provision was that this property would revert to the estate after he had received the specified amount?

A. That is right.

Q. Did your consider this in any way to be a loan or a mortgage?

A. No, sir.

Q. When you made the transfer, or when you executed this instrument, did you have any agreement with Black-

burn of any nature under which you guaranteed to Blackburn, or to anyone else, that this property that was transferred to him would produce the $10,000,000.00 and interest thereon as provided therein?

A. No, I made no agreement or guarantee. He had engineers to see it.

Q. Did you have any agreement with him, or with anyone else, that you would indemnify, or save, either Mr. Blackburn or anyone else in the event the property did not produce the agreed amount?

A. No.

[fol. 181] Q. Did you have any agreement in the nature of an option, or an agreement, to re-purchase in the event the properties would not pay out?

A. No, sir.

Q. Did you execute any notes, or anything of that kind?

A. No. Well, shortly later after that Mr. Blackburn in order to raise the purchase money, dealt with the Chase National Bank in New York.

Q. I would like to ask you did you have anything to do with that whatsoever, with the way of, or the means of, Mr. Blackburn procuring the purchase money in this case?

A. None whatsoever.

Q. Specifically did you deal in any way, or negotiate in any way, with the Chase National Bank in New York?

A. No. I will qualify that by saying I made available to him deed records and things of that sort, to their attorneys.

Q. Now, one further question. If these properties that were transferred, the royalties that were transferred, had not paid the agreed sum, where would that risk have fallen on you or the estate, or on Mr. Blackburn, in your opinion?

A. It would fall on Mr. Blackburn; he bought it.

Q. Now, I would like to ask you, Mr. O'Connor, to tell us the necessity for making this particular transaction; will you tell us the financial condition of the estate at the time, and the purposes of raising the funds, and the reasons for raising it in this way, in your own words?

[fol. 182] A. Well, may I use a memorandum I made up here of the facts and figures. As of the time, the latter part of November, 1948, final Federal estate taxes on the estate of Thomas O'Connor had been determined to be $13,360,000.00, that is round figures. The State inheritance tax

had been calculated to be $3,265,000.00. The estimated income of the estate—the income taxes of the estate for the year, fiscal year, 1948, which was to end in just a few days, exclusive of any oil payment, was estimated to be $2,755,000.00, or a total tax liability of the estate, inheritance and income taxes of $19,376,000.00. Now, prior to the time this oil payment was sold, as executor I had paid the Government $10,755,000.00 of Federal estate taxes, and I had paid the State of Texas $1,105,000.00 in State inheritance taxes, for a total amount of $11,860,000.00. Taxes still due after those payments as of about the date of this sale was $7,516,000.00. The Estate had cash on hand of approximately $3,300,000.00, to leave $7,516,000.00 worth of taxes, or we had a deficiency in cash of some $4,216,000.00. Now, after selling this oil payment——

Q. May I break in for just a moment. You said you had $3,000,000.00 plus of cash on hand?

A. Approximately $3,300,000.00.

Q. Did you have cattle or stock or other liquidated assets on hand?

A. No. I had at that time liquidated all of the assets of the Estate except land and mineral interests attached to it, and of course, cash. I sold the stocks, bonds, cattle, equipment; everything.

Q. So, even after those sales, and liquidation of those assets, your cash deficiency was, as you say, what?

[fol. 183] A. The cash deficiency ws $4,216,000.00.

Q. Now, proceed with the oil payment.

A. Well, I had calculated that, using ordinary income tax rates, which the bureau advised me were applicable at the time, that I would have a net of about $4,380,000.00 proceeds from that sale of the oil payment to apply against this $4,216,000.00 deficieney, which left me some $165,000.00 to clear up things like costs of settling the Estate; attorneys' fees; and accounting; ad valorem taxes and things of that sort.

Q. And the money so raised was actually devoted to these taxes as you have related?

A. It was.

Q. And after the tax liability had been taken care of out of the proceeds derived, you had left—what did you say?

A. I think about $165,000.00.

Q. That was to take care of the administration and other operating costs?

A. Yes, and ad valorem taxes.

Q. Now, Mr. O'Connor, I would like to go back just a moment to the transaction with Mr. Blackburn. I will ask you if in delivering the instrument in question, the transfer that was recorded in the Deed Records of Refugio County, involved in these royalties, did you cause to be attached to said instrument documentary stamps as required by Federal laws?

A. Yes. I have a photostat of my check in the amount of $10,990.00 for documentary stamps.

[fol. 184] Q. That amount was used in the purchase of documentary stamps, and you caused those stamps to be affixed to the instrument in question?

A. Yes.

Q. Now, Mr. O'Connor, I want to pursue one other line of testimony. This relates to the character of the property in question, and to the activities of your father before he died, and to the activities of the executor, on the question of whether you were conducting—of your activities in selling this oil payment and royalty. You said that these royalties, which were the subject matter of this transfer, came to the Estate at the death of your father?

A. That is right.

Q. Now, will you tell us how your father came to obtain those royalties?

A. Well, my father, under the will of his father, his name was Dennis O'Connor, who died in 1900, received a portion of Dennis O'Connor's Estate, which was run together as one unit until January 1st, 1908, at which time the land in question was partitioned to my father, Thomas O'Connor. It was the Cullen Creek Ranch; the name of the property. It was a cattle ranch, and until leased for oil that was the only thing that was done with it.

Q. Do you know about what time your father leased these properties?

A. About 1934.

Q. And in that lease he reserved certain specified royalty interests, is that right?

A. Yes.

[fol. 185] Q. And those same royalty interests passed to the Estate and to the heirs, at his death?

A. That is right.

Q. And that same royalty interest was transferred to Blackburn in the instrument in question with the revertible provision that after Mr. Blackburn had regained the certain $10,000,000.00 plus interest that is in question?

A. That is true.

Q. Now, let me ask you, did you, or did your father, so far as you know, in his lifetime and prior to this death, buy and sell royalties or other mineral interests?

A. No.

Q. So far as you know did he ever buy any royalties of any kind?

A. No.

Q. Then, as far as selling mineral interests—of course, he leased this property?

A. Of course, he leased the property.

Q. But having made a lease on his ranch property, did he at any time sell any royalty?

A. No, he never sold any.

Q. Now, I will ask you whether the Estate, following his death, except for this particular transaction, bought or sold royalties, or other mineral interests?

A. No, they never did.

Q. So far as you know did he ever, during his lifetime, make a transaction of this kind in which he sold, we will [fol. 186] say, an oil payment?

A. No, he didn't.

Q. Did the executors of the Estate, of his Estate, preceeding this transaction, may any comparable oil payment transactions?

A. No, we never made any at all.

Q. In this period of time did the heirs of the Estate buy and/or sell oil payments?

A. As a member of a partnership of an oil firm I participated in the sale of an oil payment prior to the time of this sale.

Q. And that was one oil payment sale that you made through a partnership?

A. That is right.

Q. That partnership was composed of yourself and others?

A. Three others.

Q. Three others. Now, what was the purpose of that sale?

A. That purpose was to raise money to drill oil wells.

Q. And other than that had there been any other oil payment transactions up to the date of the occasion of this sale?

A. No.

Q. Now, I am sorry I didn't ask you this before, but when we got into the question of the purposes to which these funds were to be devoted, may I ask you why it was [fol. 187] that you elected to sell an oil payment to Blackburn rather than borrow the money from a bank?

A. My reason was simply that as executor of the Estate if I could sell an asset and get the cash to pay off the debts and distribute the corpus of the Estate, what was left, I would be discharged from my obligation as executor. I was keenly desirous of having that done. If I had borrowed the money I would have had a debt hanging over that would have taken years——

The Court: Raise your voice, please.

A. As I said, my purpose in selling an oil payment rather than borrowing the money was that I wanted to be through with the thing once and for all. I wanted to sell something and get the money to pay the debts and get released as executor of the Estate after having distributed the remaining assets.

Q. You did not desire to distribute the assets to the heirs along with a very large debt; that it would be necessary to pay the taxes?

A. That is right. It was my understanding that as executor I would have to continue to serve until the debts were paid.

Q. You spoke of this oil payment being made by your partnership for the purpose of getting funds to produce oil and gas; was your father a member of that partnership?

A. No.

Q. Was outside members—were there any members of that partnership who were outside of the family?

A. Yes.

Mr. Jackson: I believe that is all.

[fol. 188] Cross-examination.

Questions by Mr. Mehaffy:

Q. Mr. O'Connor, it is stipulated in this case that we have a schedule showing the amounts in barrels and dollars of production of the property described in this transfer instrument for 1949, 1950 and 1951. Could you tell us from your own knowledge whether or not approximately the same production was had from these same properties for 1952, 1953, '54, and as of the present date?

A. Well, production, of course, has not been as great in later years, because proration has cut down production. The rate of permissive flow is much less than it was at that time.

Q. But there has been no real difference in the productivity of the property as a whole since 1949 and '50, '51?

A. Oh, yes. Naturally as the oil field became depleted salt water enters more and we produce vast quantities of salt water. We have had in the last two or three years to drill salt water disposal wells, and pretty expensive systems to get rid of salt water by putting it back in the ground.

Q. Well, of course, that is true in any producing area at certain times, generally speaking?

A. As the fields become more depleted.

Q. But overall, generally the production has continued up to the present moment?

A. Production has continued. It hasn't been as much and——

Q. Mr. O'Connor, will you tell the Court, Please, sir, [fol. 189] who are the members of the partnership that you referred to, the partnership that made the one sale?

A. I am a member of it; my brother Tom O'Connor is a member of it; Diane Breland is a member; and L. A. Norton is a member of it.

Q. L. A. Norton is the individual who is a member of this partnership and who is not related to the O'Connors; is that right?

A. That is right.

Q. And Mrs. Breland is who; identify her?

A. Mrs. Breland is my sister.

Q. Your sister, and one of Tom O'Connor's heirs?

A. That is correct.

Q. You stated in response to Mr. Jackson's question that in relating the financial status of the Estate, and your position as executor at the time, that you had liquidated assets of the Estate and still had this deficiency in money left?

A. Yes.

Q. Remaining. To whom did you sell those assets; were there a great number of sales, or——

A. Well, there were a great many. We sold municipal bonds and government bonds, of course, on the market. We purchased—the heirs formed a partnership—formed two partnerships, and purchased——

Q. The O'Connor heirs?

A. Yes. Formed a partnership—formed two partnerships and purchased two separate herds of cattle.

[fol. 190] Q. Were outside-s, or individuals not related to your family, members of either of those two partnerships?

A. No.

Q. They were composed of Thomas O'Connor heirs?

A. The ones that bought the cattle, yes.

Q. Now, what else did those partnerships composed of the heirs purchase from the Estate?

A. Well, equipment, ranching equipment; saddles and cattle; horses, and things of that sort; trucks.

Q. Now, did those things to which you have just referred take care of the—substantially the greater part of the liquidation of the assets of the Estate?

A. Yes, the cattle were—well, of course, I think maybe the municipal bonds and the government bonds were bigger than the cattle, as I remember, or about the same.

Q. But the bonds and the cattle and the horses and the equipment, and those sort of things, did together make up a very substantial part of the assets when they were liquidated.

A. I would say roughly half.

Q. Now, just what other assets were there, just briefly, just generally?

A. Well, as I say, there were bonds and stock and, well, of course, cash.

Q. No, to what did your answer of "one half" refer; cattle and equipment?

A. Yes, the cattle and ranching equipment I would say represented probably half.

[fol. 191] Q. And then another substantial portion of the assets consisted of municipal bonds and other government bonds and stocks and things of that sort?

A. That is correct.

Mr. Mehaffy: Will you indulge me just a moment, your Honor. That is all, thank you.

Re-direct examination.

Questions by Mr. Jackson:

Q. Just a moment. This partnership that bought the cattle was composed of the heirs of the Estate, is that right?

A. That is correct.

Q. The same people who were heirs of the Estate?

A. That is correct.

Q. I asked you did they purchase from you as the executor of the Estate these assets at their fair market value?

A. Well, the cattle at the time we purchased them, which was sometime after the death of my father, had enhanced in value some so that the Estate sold the cattle to this partnership at somewhat a higher value than had been agreed with the Federal revenue people as their value, because of the price of cattle going up. And this involved a lot of steers who had grown up from maybe one year old to two or three years old. And the Estate realized that capital gain from the sale of the breeding herd, because the price it received was somewhat larger than the cost they had in them.

Q. The individual members of this partnership with their own resources and their own funds, purchased these, shall [fol. 192] we say, frozen assets from you as executor of the Estate with their own funds?

A. That is correct.

Mr. Jackson: I believe that is all, your Honor.

Mr. Mehaffy: That is all, your Honor.

Mr. Jackson: Thank you, Mr. O'Connor. I would like to call Mr. Dave Blackburn.

Mr. Mehaffy: I understood Your Honor to say that my objection was carried through, carried forward through all of Mr. O'Connor's testimony?

The Court: I finally said it was overruled after finding out his purpose, counsel, after finding out his purpose, which he stated was for the purpose of showing the faith of the transaction, but not for the cause of the sale.

Mr. Mahaffy: And my objection as to his interpretation is overruled?

The Court: It is overruled.

Mr. Mehaffy: The written instrument itself is——

The Court: For the purpose of the sale; which he testified.

Mr. Mehaffy: Well, he finally said, "Yes, it was a sale and in no sense a mortgage."

The Court: That is right, and you objected to that.

Mr. Mehaffy: Yes, sir.

The Court: And I overruled that objection.

(Thereupon the witness stood aside.)

[fol. 193] D. E. Blackburn, a witness called by the plaintiff, being duly sworn, testified as follows:

Direct examination.

Questions by Mr. Jackson:

Q. Your name is D. E. Blackburn?

A. Yes, sir.

Q. Mr. Blackburn, were you a participant in the transaction with Mr. Dennis O'Connor, which transaction has been referred to in the stipulation which was filed with the Court?

A. Yes, sir.

Q. Will you tell us your understanding of what that transaction was?

A. Well, my understanding was that, that we had there, I bought a $10,000,000.00 oil payment from him.

Q. That you bought a $10,000,000.00 oil payment; you were not lending him the money?

A. No, sir.

Q. Now, did you have any other agreement with him relating to that transaction, such as an agreement that he would indemnify you, or save you harmless, from any loss in case the oil payment did not pay out?

A. No, sir.

Q. Did he guarantee that oil payment in any way?

A. No, sir.

Q. Did he have any agreement with you, relating to your rights to resell it to him?

A. No, sir.

Q. In the event it did not pay out?

A. No, sir.

[fol. 194] Q. Now, where did you get the money with which to pay him this $9,900,000.00?

A. I borrowed that money from the Chase National Bank in New York.

Q. And you borrowed that money yourself?

A. Yes, sir.

Q. Did you give to the bank your own personal note?

A. Yes, sir.

Q. Was that a negotiable note?

A. Yes, sir.

Q. What was the term of that note?

A. It was a thirty-six month note payable out of the oil returns on that oil payment.

Q. What was the interest rate on that note?

A. Four per cent.

Q. Was that note secured in any way?

A. Secured by a Deed of Trust on the oil payment.

Q. The oil payment bore interest at four per cent—did you say that the interest rate on the note that you gave to the Chase National Bank was four or three and a half per cent, the interest rate on the note to the Chase National Bank?

A. It was three and a half per cent that I paid the Chase National Bank, and the oil payment was four per cent; four per cent on the payment.

Q. Are you related in any way to the O'Connors by blood or by marriage?

A. No, sir.

Q. What is your profession or business capacity?

A. I am a banker.

[fol. 195] Q. Banker?

A. Yes, sir.

Q. And what was your official capacity or position at the time of this particular transaction?

A. I was president of the Victoria Bank and Trust Company.

Q. And you are a stockholder in that bank?

A. Yes, sir.

Q. You are not an employee of any of the O'Connors?

A. No, sir.

Q. And you were not at the time this transaction was made?

A. No, sir.

Q. Now, when this transaction was made did you make that individually and in your own right, or as an official of the bank?

A. I made it in my own right.

Q. Did you make a profit on this particular transaction?

A. Yes, sir.

Q. Approximately how much profit did you make on the transaction?

A. A gross profit of approximately $110,000.00.

Q. Did you report that profit to the Government for income tax purposes, to pay income taxes thereon?

A. Yes, sir.

Q. You did that personally?

A. Yes, sir.

Q. Did the bank have any interest whatsoever in that transaction?

[fol. 196] A. None at all.

Q. Are, or were, the O'Connors, at this time to your knowledge, stockholders in the Victoria Bank and Trust Company?

A. They were.

Q. All right. Take the family collectively; what total percentage of stock would you say the O'Connors owned at that time?

A. They owned approximately twelve per cent.

Q. And the remaining percentage was held by others?

A. By various stockholders.

Mr. Jackson: I believe that is all, Mr. Mehaffy. Your witness.

Cross-examination.

Questions by Mr. Mehaffy:

Q. Mr. Blackburn, you stated, I believe, that you had no side agreements or guarantees or anything of that sort with Mr. O'Connor, or with the O'Connor Estate, which would protect you or guarantee that you would receive this $10,000,000.00 plus interest?

A. That is right.

Q. The only assurance that you had was the properties involved in oil payment?

A. That is right.

Q. The production of oil from those properties.

A. Yes, sir.

Q. And the only security you gave to the Chase National Bank was a deed of trust on that payment, which you got by reason of this assignment?

A. Yes, sir.

[fol. 197] Q. And you entered into that transaction necessitation your borrowing $10,000,000.00 from the Chase National Bank, agreeing to pay interest at the rate of three and a half per cent, with the expectation of making a profit of the amount that you mentioned, which was $110,000.00?

A. Yes, sir.

Q. And what was your expectation with regard to your financial security in the transaction; did you have any evidence or information availiable which assured you that you would receive this sum of money?

A. Yes, sir. I had the oil payment on those oil royalties from the Tom O'Connor Estate, I owned them.

Q. What information did you and Chase National Bank have with respect to the value of this oil payment?

A. I was personally more or less familiar and knew something about these oil royalties, and then we had engineers' reports on it on the values there, and we also had the Government's report on the value in the settlement of the Estate, the taxes. So we more or less knew the values

at the time we purchased it, and, of coure, the Chase National Bank naturally had their own engineers to come down and put a value on it.

Q. That information, of course, was available, or made available to both you and Chase National Bank before either of you would enter into such an agreement?

A. No, sir. That was made available to us before the transaction was finally consummated, but I bought the payment from them at the time. I had a commitment from the Chase National Bank for the loan subject to the approval of their engineers.

Q. Subject——

[fol. 198] A. And the title proved up.

Q. Subject to approval of the collateral?

A. That is right.

Mr. Mehaffy: Excuse me one moment. That is all, Your Honor.

Mr. Jackson: The Plaintiff rests, Your Honor. That is all.

Mr. Mehaffy: That is all for the Defendants, Your Honor.

The Court: All right, gentlemen. The Court will take this matter under advisement. Mr. Jackson, how long would it take you to get up a brief and a written argument?

Mr. Jackson: A week or ten days, Your Honor.

The Court: You can get one up in that time?

Mr. Jackson: Yes.

The Court: I will give you two weeks. What about you, Counsel?

Mr. Mehaffy: Your Honor, may I make a little statement? Mr. Jackson has been most cooperative, and we have, subject to his commitments and mine there, in and out of town, have done the best we could to expedite this matter. I would like to be given ample time to prepare a brief after receipt of Mr. Jackson's brief, with the understanding that I will represent to the Court that it will be forthcoming at the earliest possible moment. In other words, if I have no trips at that particular time out of the office I will get the brief out immediately.

The Court: Well, how much time do you think it would take after you get Mr. Jackson's brief?

[fol. 199] Mr. Mehaffy: I think three weeks would be ample.

The Court: I will give you thirty days.

Mr. Mehaffy: Thirty days? I will make every attempt to do it.

Mr. Jackson: Is that thirty days after receipt of my brief?

The Court: Yes. And you may have ten days after your receipt of his brief in which to reply.

Mr. Jackson: Thank you, Your Honor.

The Court: Anything further?

Mr. Jackson: I believe that is all.

Mr. Mehaffy: No, that is all.

Mr. Jackson: Thank you very much.

The Court: The court will recess.

Thereupon at 10:25 A.M., Friday, November 4, 1955, the trial of this case was closed in the San Antonio Division of said Court.

[fol. 200] Reporter's certificate of foregoing transcript ommitted in printing.

[fol. 201] In United States District Court

Memorandum Opinion—February 20, 1956

The Court, having considered the evidence adduced upon the trial of this cause and the briefs of the parties, finds that the plaintiffs are entitled to judgment herein.

The Clerk will notify the attorneys of record in this cause of the opinion of the court, and request plaintiffs to prepare and submit to the court tentative findings of fact and conclusions of law, and judgment, and furnish copies thereof to the attorneys for the defendant.

(Signed) Ben H. Rice, Jr., United States District Judge.

[fol. 202] IN UNITED STATES DISTRICT COURT

JUDGMENT—March 27, 1956

The above-entitled action was heard on November 4, 1955. Came the plaintiffs by and through their attorneys, and came the defendant by and through the United States Attorney for the Western District of Texas. Each announced ready for trial. The Court heard the pleadings and has considered the evidence and arguments of counsel. The Court is of the opinion that plaintiffs are entitled to judgment of defendant in the amount of $3,607,153.59, plus allowable interest and court costs.

It is therefore ordered, adjudged and decreed that plaintiffs, Dennis M. O'Connor and Katherine O'Connor, Independent Executors of the Estate of Thomas O'Connor, Deceased, and Dennis M. O'Connor, and Katherine O'Connor, Mary O'Connor Braman, joined herein by her husband, D. H. Braman, and Thomas O'Connor, Jr., do have and recover of and from the defendant, judgment in the amount of $3,607,153.59 with allowable interest and court costs.

Dated at Waco, Texas, this the 27th day of March, 1956.

(Signed) Ben H. Rice, Jr. Judge, United States District Court Western District of Texas.

[fol. 203] IN UNITED STATES DISTRICT COURT

CERTIFICATE OF PROBABLE CAUSE—Filed: March 27, 1956

The Court hereby certifies that there was probable and reasonable cause for the act of the defendant, the Collector of Internal Revenue, in demanding and collecting from the plaintiffs the internal revenue tax, for the refund of which Judgment was entered in the above-entitled action on the 27th day of March, 1956.

Dated at Waco, Texas, this 27th day of March, 1956.

(Signed) Ben H. Rice, Jr. Judge, United States District Court, Western District of Texas.

[fol. 204] In United States District Court

Findings of Fact and Conclusions of Law—Filed March 27, 1956

This case arises under the provisions of the Internal Revenue Code of 1939. It involves income taxes together with interest paid by the Estate of Thomas O'Connor, Deceased, for the taxable year ended November 30, 1948.

The above-entitled action was tried without jury by the Court in San Antonio, Texas, on November 4, 1955.

The question involved in the case is as follows:

Were the plaintiffs taxable at long term capital gain rates or at ordinary income rates on the gain realized from the sale of an oil payment during the fiscal year ended November 30, 1948, to D. E. Blackburn?

The Court having considered the oral testimony, stipulated facts and the briefs of counsel and being fully advised otherwise in the premises, makes and enters the following findings of fact and conclusions of law.

Findings of Fact

1. Thomas O'Connor died testate in Victoria County, Texas, on December 5, 1946. Plaintiffs Dennis M. O'Connor and Katherine O'Connor, duly qualified as Independent Executors of the Estate of Thomas O'Connor, Deceased, and are now acting in such capacity. Plaintiffs Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman and Thomas O'Connor, Jr. are the sole heirs at law and devisees under the will of Thomas O'Connor, deceased. D. H. Braman is the husband of Mary O'Connor Braman. [fol. 205] 2. In the fiscal year of the Estate ended November 30, 1948, to-wit, on November 26, 1948, the Executors of the Estate transferred, by general war-anty deed, certain royalty interests (subject to a reversionary interest, as hereinafter stated) to D. E. Blackburn of Victoria, Texas, for the cash consideration of $9,990,350.00. The deed making such transfer was delivered to D. E. Blackburn and duly recorded in the Deed Records of Refugio County, Texas, with some $10,000.00 in documentary stamps having been attached to the deed. Expenses attributable to the sale amounted to $10,990.00. The royalty interests sold to

Blackburn had been held by decedent and subsequently by his Estate for many years. The properties sold to Blackburn had been held by plaintiffs in excess of six months.

3. If the gain from the transaction in question is properly taxable as income on the sale of a capital asset held for more than six months, and not as ordinary income, the basis for computing such gain is $1,925,105.81.

4. The above mentioned transaction was consummated on November 26, 1948 and was carried out in accordance with its terms. Blackburn, as owner of the royalty interest, received the money from the companies running the oil from the properties, pursuant to transfer orders executed by plaintiffs to the respective pipe line companies.

5. The deed above referred to provided that after the royalties described therein had produced sufficient oil to pay the purchaser, D. E. Blackburn, the sum of $10,000,000.00 (with interest as computed thereon at the rate of 4% per annum), the properties would revert to the grantors. The aforesaid amount was duly received by Blackburn from said properties during the period beginning January 28, 1949 and ending December 24, 1951. Upon [fol. 206] receipt of this amount, Blackburn, the purchaser, pursuant to the provisions in the deed, executed his quitclaim deed, reconveying the royalties to the Estate, which quitclaim was duly recorded in the Deed Records of Refugio County, Texas.

6. Both the sellers and the buyer (D. E. Blackburn) intended the transaction in question to be a sale and purchase of the royalty interests in question. They did not intend to enter into a loan or a mortgage transaction. At no time did the Executors, individually, or in their fiduciary capacity, make any guaranty or agreement to indemnify the purchaser or enter into agreements with the purchaser other than the agreement to sell, as set forth in the deed. At all times, the risks incident to the presence and production of sufficient quantities of oil to make the transaction profitable for the purchaser were upon the purchaser. The purchaser, D. E. Blackburn, borrowed the purchase money from Chase National Bank of New York, giving his note and a deed of trust on the properties purchased by him. The bank dealt only with Blackburn and looked only to him. The plaintiffs did not have anything to do with Blackburn's

bank loan. The transaction in question was real and bona fide and was, in no sense, a sham or a subterfuge. Blackburn made a substantial profit on the transaction and reported and paid tax on his profit.

7. The purpose of the sale of the oil payment was a bona fide business purpose, to-wit, to raise money to pay federal estate taxes and state inheritance taxes due by reason of the death of Thomas O'Connor, deceased, and to pay administration expenses of the Estate. The Estate was in need of cash resources with which to pay these charges and for these reasons the oil payment was sold.

[fol. 207] 8. The sale in question was the first and only sale of oil payments or other mineral interests that the Estate had made until that time. Neither the decedent, Thomas O'Connor, nor his Estate, was in the business of selling oil payments or other mineral interests. The limited royalty interests, the oil payment in question, was not held primarily for sale to customers.

9. The oil payment "paid out" after three years of production, during which the properties were owned by Blackburn. The oil payment would have taken an appreciably longer period to pay out had it not been for the fact that there was an increase in the production in the field by the operating lessees and had it not been for the further fact that there had been a substantial increase in the price of oil shortly prior to the sale of the oil payment, which higher price was maintained during the period of the pay-out.

10. The royalty interest (or oil payment) sold to Blackburn represented a substantial part of the plaintiffs' oil in place. Also, in terms of the relative values of the interest sold and of the reversionary interest retained by the sellers, the transfer represented a substantial part of the sellers' royalty interest.

11. The Executors of the Estate of Thomas O'Connor, Deceased, filed a fiduciary income tax return for the fiscal period ended November 30, 1948, reporting the gain on the sale as ordinary income. This gain was reported as ordinary income because of the ruling of the Commissioner of Internal Revenue, published in 1948, requiring such gain to be so reported. Thereafter, a timely claim for refund was filed, which was rejected (except as to a minor item not here involved), notification of such rejection being received in a registered letter dated March 12, 1953, and sub-

[fol. 208] sequently, this suit was brought within the time prescribed by the Internal Revenue Code.

12. There was probable and reasonable cause for the acts done by Frank Scofield, the former Collector of Internal Revenue, acting pursuant to the orders and directions of the Commissioner of Internal Revenue.

Conclusions of Law

1. This Court has jurisdiction of the subject-matter of and the parties to this case.

2. The transaction with D. E. Blackburn was a bona fide sale.

3. The sale to Blackburn was a sale of a royalty interest in producing oil properties in Texas, subject to a reversion to plaintiffs after the royalties had produced in Blackburn's hands the prescribed amount. This was a sale of what is commonly called an oil payment. This oil payment was a real property interest under the law of Texas, and, under the tax laws, a property interest in oil in place. The transaction was not intended to be and was not, as a matter of fact or a matter of law, an assignment of income, but was the sale of a property interest to Blackburn, which property interest produced income in the hands of Blackburn. This property interest was substantial and real, representing a substantial part of the grantors' royalty interest. The property so sold was a long-lived, and not a short-lived, oil payment.

4. The property interest so sold to Blackburn was a capital asset as defined in Section 117 of the Internal Revenue Code of 1939, and this capital asset had been held by plaintiffs for more than six months.

[fol. 209] 5. None of the exceptions in Section 117 or elsewhere in the Internal Revenue Code, denying a transaction long term capital gain treatment, are applicable to the instant transaction.

6. Plaintiffs are entitled to receive long term capital gain treatment under Section 117 on the sale of the oil payment in question to Blackburn.

7. Judgment shall be entered for the plaintiffs. By reason of the probable cause for the acts of the Commissioner or other officials of the Treasury Department, as found by the Court, the judgment, on becoming final, shall be pro-

vided for and paid out of the propert appropriations from the Treasury of the United States.

(Signed) Ben H. Rice, Jr., United States District Judge.

March 27, 1956.

[fol. 210] In United States District Court

Notice of Appeal in the Court of Appeals Under Rule 73(b)—Filed April 18, 1956

Notice is hereby given that Frank Scofield, Former Collector of Internal Revenue, defendant above named, hereby appeals to the United States Court of Appeals for the Fifth Circuit from the memorandum opinion entered on February 20, 1956, and from the final judgment entered on March 28, 1956.

(Signed) Russell B. Wine, United States Attorney for the Western District of Texas, P. O. Box 1701, San Antonio, Texas.

Certificate of Service (omitted in printing)

[fol. 211] In United States District Court

Designation of Contents of Record on Appeal—Filed April 28, 1956

Pursuant to Rule 75(a) of the Federal Rules of Civil Procedure, the defendant-appellant hereby designates the following portions of the record, proceedings and evidence to be contained in the record on his appeal from the final judgment herein:

1. The entire record of the above proceedings, including all docket entries.

(Signed) Russell B. Wine, United States Attorney, 347 Federal Building, San Antonio, Texas, Attorney for defendant-appellant.

[fol. 212] In United States District Court

List of Docket Entries

[Title omitted]

Basis of Action: Income Tax Case. $3,613,173.03

Mar. 4, 1955. Complaint filed.

Mar. 4, 1955. Summons & 3 Copies (with copy of Complaint attached) issued.

Mar. 16, 1955. Summons Ret. & filed. Ex. 3-4-55 by deliv. copy to Frank Scofield in person & on 3-14-55 by Deliv. Copy to Russell Wine, U. S. Atty., and mailing copy to Atty. Gen. at Washington, D. C. (Trautwein $4.40; Bain, $6.40).

May 4, 1955. Order extending time for filing Answer filed & Ent'd.

May 11, 1955. Answer filed.

Feb. 20, 1956. Memorandum Opinion filed.

Mar. 27, 1956. Findings of Fact and conclusions of Law filed.

Mar. 27, 1956. Judgment ($3,607,153.59 with interest & [fol. 213] costs in favor of Pltffs.) filed & Ent'd.

Mar. 27, 1956. Certificate of Probable Cause filed.

April 18, 1956. Notice of Appeal In the Court of Appeals under Rule 73(b) filed.

Apr. 28, 1956. Designation of Contents of Record on Appeal filed.

May 14, 1956. Court Reporter's Q. and A. Transcript.

[fol. 214] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 215] Minute Entry of Argument and Submission—December 3, 1956, omitted in printing

[fol. 216] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16253

FRANK SCOFIELD, Former Collector of Internal Revenue, Appellant,

versus

DENNIS M. O'CONNOR and KATHERINE O'CONNOR, Independent Executors of the Estate of Thomas O'Connor, Deceased, and Dennis M. O'Connor, Kath-rine O'Connor, Mary O'Connor Braman, Joined by Her Husband, D. H. Braman, and Thomas O'Connor, Jr., Appellees

Appeal from the United States District Court for the Western District of Texas

OPINION—February 1, 1957

Before Hutcheson, Chief Judge, and Holmes and Borah, Circuit Judges

HUTCHESON, Chief Judge:

One of several appeals [1] from judgments entered in favor [fol. 217] of taxpayers, after Caldwell's case [2] and before Hawn's case [3] had been decided here, this appeal presents the single question whether, in the light of those cases, a transaction involving oil payments carved out of royalty interests was, as claimed by the taxpayer and found by the trial court, a sale of a capital asset, or was, as claimed by the commissioner, an anticipatory assignment of income.

Making no attack upon Caldwell, in fact conceding in oral argument that it was correctly decided, appellant's whole effort is directed to bringing us into agreement with

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[1] Fleming v. Commissioner, 24 T.C. 818; Wrather v. Commissioner, T.C. ; Weed v. Commissioner, 24 T.C. 1025; Lake v. Commissioner, 24 T.C. 1016.

[2] Commissioner v. Caldwell, 218 F(2) 567.

[3] Commissioner v. Hawn, 231 F(2) 341.

his contentions: That in Hawn's case this court *held* that, though Congress had provided no standard or guide, this and other courts, by the use of a kind of slide rule method not clearly if at all revealed in the decision, could, in their uncontrolled discretion, determine as a fact in each case whether a sale of an oil payment interest is or is not too insubstantial to qualify for capital gains treatment under Section 117; and that, in the exercise of this fact finding power, we should hold as a fact that, because of the insubstantiality of the transaction, the sale made here was not a sale.

It is taxpayer's position: that this court did not in Hawn's case in anywise qualify or limit Caldwell; that it particularly did not hold that, without a legislative standard to guide its decision, it had the power to determine in each case, as a fact, whether an assignment would or would not be regarded as insubstantial; and, finally, that Hawn's case was decided not on the ground of the factual insubstantiality as such of the property purportedly [fol. 218] sold, but on the ground that the facts as a whole did not in law show a sale of property at all but only a loan arrangement.

In support of its view that the court did not intend to lay down any slide rule method of factually determining in each case the insubstantiality of a transfer, but that the case was determined on the ground that, upon its whole facts, what took the form of, was not in fact and in law, a sale, the taxpayer points to the decisive holding of the court:

> "* * * The agreements showed that the parties contemplated using the oil payments over the next two years for the construction of a house for Hawn. * * * The effect was the same as though Hawn had borrowed the funds required, using the oil payments as collateral, and applied the proceeds of such loans to pay the contractor, and then repaid his loans as the oil payments were received. * * * *"

So pointing, he urges upon us that since, as was held in that case, there was no sale but only a loan transaction, the court did not, as the commissioner urges it did, establish, or even undertake to establish, a slide rule for

determining insubstantiality as to a bona fide sale which, upon the stipulated facts and the findings of the trial court, the sale in question here was.

It is true that this court, thus properly deprecating the absence of legislative guide or standard:

> [fol. 219] "Although it might be better if congress[4] provided the answer, in the absence of a congressional determination, it devolves on the court to supply it."

did state that, along with other facts going to the legal effect of the transaction as a whole, the court should determine "whether such transfer is for a substantial interest in the total property owned by the transferor".

It is equally true, however, that it did not undertake to decide the Hawn case on, or in it lay down, any quantitative rule or other guide, fractional or otherwise, for the factual determination by the court in that or any other case as to what would or would not be substantial. Neither did it undertake to hold that if, instead of a fictional or pretended sale, as the court found that the purported sale was, there had been a real sale of an oil payment of $115,000, the court would have been authorized to hold or would have held, that it was insubstantial in amount and, because and only because thereof, it was not a sale.

To the contrary, stating:

> "It is clearly true, as already indicated, that an oil payment like royalty is an interest in property, an interest in realty, and an interest in minerals in place."

and declaring:

> "Deciding, as we do, that not every transfer of oil payments, even for a valuable consideration, [fol. 220] amounts to a sale of capital assets under Sec.

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[4] The Mills Bill, H.R. 9559, dealing prospectively with oil payment sales and related transactions, introduced in the last congress but not passed, illustrates the desirability of legislation to bring about certainty and clarity in this important area of the tax law.

> 117, it becomes necessary for us to determine whether, under the established principles, this transaction was or was not such a sale."

the court went on to say:

> "Upon careful review of the cases and equally careful consideration of the circumstances of this particular transaction, we conclude that this was not such a sale but was rather an assignment of anticipatory income which remained taxable to the respondent."

This is to say, that the court, correctly concluding, on the whole facts, not that there was a bona fide sale which, because in amount it was insubstantial, did not come within Section 117, but that this was not a sale at all, it was a credit arrangement, which, though in form an assignment of the oil interest it purported to deal with, was in fact and in law nothing but an anticipatory assignment of income made as security for, and in payment of, Hawn's debt to the contractor, as correctly *held* that the course of dealings did not amount to a sale or exchange of capital assets under Section 117.

We, therefore, agree with the taxpayer that if, as commissioner contends, this court in the Hawn case did, and we should, without a legislative standard or guide, determine as matter of fact whether and where a time limit was to be drawn upon whether a sale of oil payments was substantial or insubstantial enough to constitute a sale entitling taxpayer to capital gains treatment, the result would be not deciding but mere fiating, or, at best, unwarranted judicial legislation.

[fol. 221] If, however, on the other hand, as the Hawn case held and we hold, the court in each case takes all of the facts into consideration for the purpose of determining whether, as matter of law, a transaction was or was not a sale of capital assets, so as to entitle it to capital gains tax treatment under Sec. 117, the court would only be following and applying the rule laid down in the cases, that not every sale of capital assets, but only those which in law come under the statute, will support capital gains treat-

ment,[5] and that it would be running a good principle into the ground if a taxpayer would be allowed to claim as a sale of capital assets the daily use of small portions thereof in connection with his business and the payment of his day to day expenses.[6]

That the transaction in this case was not of an insubstantial kind is shown, by the fact that it involved a cash [fol. 222] sale for $9,990,350 of an oil payment conveying 4,000,000 barrels of oil in place, and by the undisputed facts and the oral testimony of two witnesses, the government's brief stating, "The oral testimony in uncontradicted and accordingly there are no disputed facts".

It is further shown by the definite and precise findings of the district court which, after setting out the full transaction, categorically and specifically found that the

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[5] Rudco Oil & Gas Co. v. United States, 82 Fed. Supp. 746, "a case", as we pointed out in Caldwell v. Campbell, 218 F(2) 570, "of a corporation dealing deviously through its stockholders * * *". * * * "It was in effect a mere appointment of the stockholders to receive the mineral income of the corporation for sixty or ninety days of the taxable year in which the purported transfer was made. It was, therefore, a completely abortive attempt, like those dealt with in the Horst, the Harrison, and the Eubank cases, to change the statutory rule for the taxation of income by appointing one to collect as his own the income of another."

[6] Cf. what is said by the Supreme Court in Burnet v. Harmel, 287 U.S. 103, arguendo and by decision, and in Corn Products Co. v. Commissioner, 350 U.S. at page 52:

> "* * * Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss.' The preferential treatment provided by Sec. 117 applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' Burnet v. Harmel, 287 U.S. at 106."

transaction was a bona fide and effective sale.[7] Based [fol. 223] upon these findings of fact, he concluded as matter of law:

> "The transaction with D. E. Blackburn was a bona fide sale.
>
> "The sale to Blackburn was a sale of a royalty interest in producing oil properties in Texas, subject to a revision to plaintiffs after the royalties had produced in Blackburn's hands the prescribed amount. This was a sale of what is commonly called an oil payment. This oil payment was a real property interest under the law of Texas, and, under the tax laws, a property interest in oil in place. The transaction was not intended to be and was not, as a matter of fact or a matter of law, an assignment of income, but was the

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[7] "Both the sellers and the buyer (D. E. Blackburn) intended the transaction in question to be a sale and purchase of the royalty interests in question. They did not intend to enter into a loan or a mortgage transaction. At no time did the Executors, individually or in their fiduciary capacity, make any guaranty or agreement to indemnify the purchaser or enter into agreements with the purchaser other than the agreement to sell, as set forth in the deed. At all times, the risks incident to the presence and production of sufficient quantities of oil to make the transaction profitable for the purchaser were upon the purchaser. The purchaser, D. E. Blackburn, borrowed the purchase money from Chase National Bank of New York, giving his note and deed of trust on the properties purchased by him. The bank dealt only with Blackburn and looked only to him. The plaintiffs did not have anything to do with Blackburn's bank loan. The transaction in question was real and bona fide and was, in no sense, a sham or a subterfuge. Blackburn made a substantial profit on the transaction and reported and paid tax on his profit.

"The purpose of the sale of the oil payment was a bona fide business purpose, to-wit, to raise money to pay federal estate taxes and state inheritance taxes due by reason of the death of Thomas O'Connor, deceased, and to pay administration expenses of the Estate. The Estate was in

sale of a property interest to Blackburn, which property interest produced income in the hands of Blackburn. This property interest was substantial and real, representing a substantial part of the grantors' royalty interest. The property so sold was a long-lived, and not a short-lived, oil payment.

"The property interest so sold to Blackburn was a capital asset as defined in Sec. 117 of the Internal Revenue Code of 1939, and this capital asset had been [fol. 224] held by plaintiffs for more than six months."

It will serve no useful purpose for us to set out here the undisputed facts on which the findings and conclusions were based. It will be sufficient to say that, on the record made, the district judge was right and his judgment should be Affirmed.

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need of cash resources with which to pay these charges and for these reasons the oil payment was sold.

"The sale in question was the first and only sale of oil payments or other mineral interests that the Estate had made until that time. Neither the decedent, Thomas O'Connor, nor his Estate, was in the business of selling oil payments or other mineral interest. The limited royalty interests, the oil payment in question, was not held primarily for sale to customers.

"The oil payment 'paid out' after three years of production, during which the properties were owned by Blackburn. The oil payment would have taken an appreciably longer period to pay out had it not been for the fact that there was an increase in the production in the field by the operating lessees and had it not been for the further fact that there had been a substantial increase in the price of oil shortly prior to the sale of the oil payment, which higher price was maintained during the period of the pay-out.

"The royalty interest (or oil payment) sold to Blackburn represented a substantial part of the plaintiffs' oil in place. Also, in terms of the relative values of the interest sold and of the revisionary interest retained by the sellers, the transfer represented a substantial part of the sellers' royalty interest."

[fol. 225] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16253

FRANK SCOFIELD, FORMER COLLECTOR OF INTERNAL REVENUE,

versus

DENNIS M. O'CONNOR AND KATHERINE O'CONNOR, Independent Executors of the Estate of Thomas O'Connor, Deceased, and Dennis M. O'Connor, Katherine O'Connor, Mary O'Connor Braman, Joined by her Husband, D. H. Braman, and Thomas O'Connor, Jr.

JUDGMENT—February 1, 1957.

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel:

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

[fol. 226] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 227] [Caption omitted]

[fol. 228] Docket No. 46713

IN THE TAX COURT OF THE UNITED STATES

WM. FLEMING AND BESSIE M. FLEMING (husband and wife), Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION—Filed Feb. 2, 1953

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner

of Internal Revenue in his notice of deficiency (Bureau [fol. 229] symbols Dallas—IRA:90D-D) dated November 10, 1952, and as a basis of their proceeding allege as follows:

1

The petitioners are individuals. They are now, and were at all pertinent times hereinafter referred to, husband and wife. They reside in Fort Worth, Texas, and their office is at 1218 Fair Building, Fort Worth, Texas. The return for the period here involved was filed with the Collector of Internal Revenue for the Second Collection District of Texas, at Dallas, Texas.

2

The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioners on November 10, 1952.

3

The deficiency as determined by the Commissioner is in income taxes for the calendar year 1948, in the amount of $94,113.30, substantially all of which is in dispute.

4

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The respondent erroneously failed to determine that petitioners' gain from the exchange of certain limited overriding royalty interests in oil and gas leasehold for an undivided interest (in fee simple) in ranch lands was [fol. 230] within the purview of Section 112(b)(1) of the Internal Revenue Code, so that said gain was not to be recognized in determining petitioners' taxable income for 1948.

(b) The respondent erroneously failed to determine that the gain derived by a partnership (Fleming Oil Company) of which petitioner Wm. Fleming was a member, from the exchange of certain limited overriding royalty interests in oil and gas leaseholds, for an undivided interest (in fee simple) in ranch lands, came within the purview of Section 112(b)(1) of the Internal Revenue Code, so that said gain was not to be recognized in determining

the net income of said partnership for the calendar year 1948 and in determining petitioners' distributive share of said partnership income.

(c) Alternatively, the respondent erred in failing to determine that the gain from the exchanges referred to in subparagraphs (a) and (b) above was taxable as long-term capital gain, rather than as ordinary income subject to depletion.

5

The facts upon which the petitioners rely as the basis of this proceeding are as follows:

(a) Throughout the applicable periods herein referred to, petitioners were husband and wife, residing together in Fort Worth, Texas. They kept their books and records upon the cash receipt and disbursement basis and for [fol. 231] calendar-year periods. They duly filed a joint income tax return for the calendar year 1948 upon the cash receipt and disbursement basis.

(b) Throughout the year 1948, as well as prior and subsequent thereto, there existed a partnership known as Fleming Oil Company, which had its office and principal place of business at 1218 Fair Building, Fort Worth, Texas. This partnership was primarily engaged in the business of acquiring, developing and operating oil and gas properties, but from time to time made other investments. This partnership kept its books and records upon the cash receipt and disbursement basis and accounted for calendar-year periods, and it duly filed income tax returns on such basis and for such periods.

(c) Prior to 1948, the partnership of Fleming Oil Company was composed of Wm. Fleming, a petitioner herein, in his individual capacity; Wm. Fleming Trustee, a private trust of which the said Wm. Fleming was the sole trustee and of which Mary D. Fleming Walsh, his daughter, was the beneficiary; and the Estate of Anna Maud Fleming, deceased. The said Wm. Fleming was the surviving husband of the said Anna Maud Fleming (who died in 1941 a resident of Fort Worth, Texas) and was the duly appointed, qualified and acting Independent Executor of the estate and will of said Anna Maud Fleming. The interest of the said Wm. Fleming individually in said partnership was 30.513%; the interest of said estate was 30.513%; and

the interest of the trust Wm. Fleming Trustee in said partnership was 38.974%. The respondent has heretofore determined that the administration of the estate of Anna Maud Fleming, deceased, should be considered as [fol. 232] closed for income tax purposes as of December, 31, 1947, and that thereafter Wm. Fleming Individually should report the share of the income of the partnership Fleming Oil Company which was reportable in tax returns filed on behalf of said estate for 1947 and prior years. The deficiency determination here involved, in so far as it relates to the income of Fleming Oil Company for the calendar year 1948, was determined in accordance with the foregoing, that is, there was included in the income of these petitioners for the calendar year 1948, 61.026% of what the respondent determined to be the net income of said partnership Fleming Oil Company for the calendar year 1948.

(d) On May 19, 1948, the said partnership Fleming Oil Company owned ordinary commercial oil and gas leases, or interests therein, on lands located in Texas. These leaseholds were known as the Denman "C" Lease, the Denman "H" Lease, the Reid "A" and "B" Leases, and the Snyder "C" Lease, all on lands located in Howard County, Texas. The said partnership had on that date, May 19, 1948, owned said leaseholds and interests therein, and each of them, for several years, during all of which time they were held by said partnership for productive use in its trade or business, and not as stock in trade or primarily for sale.

(e) On May 19, 1948, Fleming Oil Company aforesaid conveyed to Mrs. Marie Hildreth Cline, limited overriding royalty or oil-payment interests from the leasehold interest described in the for-going subparagraph (d), by virtue of which she, the said Marie Hildreth Cline, became the owner of fractional parts of the oil and gas then under the said lands, and became entitled to receive, sell and dispose [fol. 233] of the same when, as and if produced, until she had received from this source oil and gas of the value of $147,000, plus an amount equal to that which interest would produce when calculated at the rate of 5% per annum upon the amount of said $147,000 remaining from month to month unsatisfied. The fractional interest so conveyed in each and all of said leases was 1/2 of 7/8ths, except as to the Denman "H" Lease, as to which the fractional interest conveyed was 1/2 of 13 16ths. Fleming Oil Company received from the

said Marie Hildreth Cline, as the sole consideration for the properties so conveyed her, an undivided 50% fee simple interest in approximately 2,994.5 acres of ranch lands in Parker and Tarrant Counties, Texas, this ranch being known as the Cline Ranch. Said partnership acquired the said interest in said Cline Ranch for investment, and has continued to hold the same for that purpose since it was so acquired.

(f) Being advised and believing that the gain from the aforesaid exchange was not to be recognized in determining its income for the year 1948 because of the provisions of Section 112(b)(1) of the Internal Revenue Code, Fleming Oil Company reported no gain or loss from said transaction in its income tax return for the year 1948. Upon an investigation of said partnership tax return and the return for 1948 of these petitioners, the respondent made the following determinations:

(1) That the market value of said 50% interest in said Cline Ranch on May 19, 1948, was $147,000.

[fol. 234] (2) That the net basis in the hands of said partnership for the interests in said oil and gas leases so conveyed to Marie Hildreth Cline was $1,102.70.

(3) That said $147,000 (the value of a 50% undivided interest in said Cline Ranch) constituted ordinary income of Fleming Oil Company for the calendar year 1948.

(4) That the aforesaid amount of $147,000 represented income from the respective oil and gas leases heretofore referred to, so that said partnership was entitled to deduct an allowance for depletion equal to 27½% of said gross income, or $40,425.

(5) That said partnership's net income from said exchange was $106,575.

(g) In accordance with the determinations set out in the preceding subparagraph (f), the respondent increased the taxable income of said partnership for the year 1948 in the amount of $106,575 and added a ratable portion thereof (61.026%) to the taxable income of petitioners for the year 1948 as otherwise adjusted. A substantial portion of the deficiency here involved results from this action.

(h) On May 19, 1948, petitioner Wm. Fleming was, among other business activities, engaged in the business of acquiring oil and gas properties, developing them and

producing oil and gas therefrom. On that date the said Wm. Fleming owned a 41.667 working interest in an oil and gas lease and leasehold estate conveyed thereby on lands in Eddy County, New Mexico, this oil and gas lease being [fol. 235] known as the State (Choate) Lease. The said Wm. Fleming had owned this lease for several years prior to May 19, 1948, during all of which time he held same for productive use in his trade or business of producing oil and gas and not as stock in trade and not primarily for sale. On said date, the said Wm. Fleming conveyed to the aforesaid Marie Hildreth Cline a limited overriding royalty interest in said State (Choate) Lease, by which she, the said Marie Hildreth Cline, became the owner of 40% of 41.667% of the oil and gas then in and under said lands and thereafter to be produced from same, until she had received oil and gas of the value of $73,500 plus an amount equal to that which interest would produce when calculated at the rate of 5% per annum upon the said amount of $73,500 remaining from month to month unsatisfied. As the sole consideration for said transfer, the said Marie Hildreth Cline conveyed to petitioner Wm. Fleming an undivided one-fourth fee simple interest in the aforesaid Cline Ranch. Petitioner Wm. Fleming acquired said undivided interest in said ranch for investment, and since its acquisition has continued to hold the same solely for that purpose.

(i) Being advised and believing that the gain from the aforesaid exchange was not to be recognized in determining his income for the year 1948, because of the provisions of Section 112(b)(1) of the Internal Revenue Code, petitioners reported no gain or loss from the said transaction in their income-tax return for the year 1948. Upon an investigation of said tax return, the respondent made the following determinations:

[fol. 236] (1) That an undivided one-fourth fee simple interest in said Cline Ranch had a fair market value on May 19, 1948 of $73,500.

(2) That said sum of $73,500 constituted a part of petitioners' gross income for 1948 from the aforesaid State (Choate) Lease.

(3) That petitioners were entitled to an allowance for depletion with respect to said amount of $73,500 equal to 27½% thereof, or $20,212.50.

(4) That petitioners derived taxable ordinary income from said exchange of $53,287.50. Accordingly, respondent added said amount of $53,287.50 to petitioners' income for the year 1948 as otherwise adjusted, and a substantial portion of the deficiency here involved is based upon this determination.

(j) Petitioners allege upon information and belief that the respondent erred in determining that the gain of the partnership Fleming Oil Company, and of petitioners and each of them, from the aforesaid exchanges was to be recognized in determining the income of said partnership for 1948 and in determining the income of petitioners for the year 1958. Petitioners further allege upon information and belief that said exchanges and each of them constituted exchanges of properties of like kind within the purview of Section 112(b)(1) of the Internal Revenue Code, and that none of the excepting provisions of said section applies to either of said exchanges.

(k) Alternatively, petitioners say that if they be mistaken [fol. 237] in the position heretofore advanced, that said exchanges and each of them came within the non recognition-of-gain provisions of Section 112(b)(1) of the Internal Revenue Code, then the gain regulsting to said partnership and to these petitioners from the transactions was taxable as long-term capital gain derived from the exchange of capital assets within the purview of Section 117 of the Internal Revenue Code, and the respondent erred in failing so to hold in determining the deficiency here involved.

Wherefore, the petitioners pray that this Court may hear the proceeding and upon such hearing hold and determine (a) that the aforesaid exchanges and each of them gave rise to gain which was not to be recognized because of the provisions of Section 11(b)(1) of the Internal Revenue Code, or alternatively (b) that the gain resulting from the aforesaid exchanges and each of them was taxable as long-term capital gain under Section 117 of the Internal Revenue Code; and that they may have such other and further relief as may be entitled to receive under the facts alleged.

Harry C. Weeks, Counsel for Petitioners.

525 Fort Worth National Building Fort Worth, Texas.

Of counsel: Weeks, Bird, Gannon & Appleman, Fort Worth, Texas.

STATE OF TEXAS,
County of Tarrant:

Wm. Fleming and Bessie M. Fleming, being each duly sworn, say that they are the petitioners above named; that [fol. 238] each has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true except those stated to be upon information and belief, and that those each believes to be true.

Wm. Fleming, Bessie M. Fleming.

Subscribed and sworn to before me this 29 day of January, 1953.

Mamie Morse, Notary Public in and for Tarrant County, Texas. (Seal.)

EXHIBIT A TO PETITION

U. S. Treasury Department

Office of Internal Revenue Agent in Charge, Mercantile Commerce Building, Dallas 1, Texas

Dallas
IRA :90D-D

Nov. 10, 1952.

Mr. Wm. Fleming, and Mrs. Bessie M. Fleming, Husband and Wife, 1218 Fair Building, Forth Worth, Texas.

DEAR MR. AND MRS. FLEMING:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948 [fol. 239] and 1949 discloses a deficiency of $94,113.30 and $1,307.70, respectively, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United

States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidsys are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of C:RLP. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours, John B. Dunlap, Commissioner, by (Signed) A. H. Hertwig, Acting Internal Revenue Agent in Charge.

Enclosures: Statement, Form 1276, Agreement Form.
GN:esk.

[fol. 240] Dallas
IRA:90D-D

Statement

Mr. Wm. Fleming, and Mrs. Bessie M. Fleming, Husband and Wife, 1218 Fair Building, Fort Worth, Texas

Income Tax Liability for the Taxable Years Ended December 31, 1948 and 1949

Year	Deficiency
1948	$94,113.30
1949	1,307.70
Total	$95,421.00

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated September 5, 1951; to your protest dated January 15, 1952; and to the statements made at the conference held on April 2, 1952.

A copy of this letter and statement has been mailed to your representative, Mr. Harry C. Weeks, Fort Worth National Bank Building, Fort Worth, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

[fol. 241]

Schedule 1

Taxable Year Ended December 31, 1948

Adjustments to Net Income

Net income as disclosed by joint return		$151,621.67
Additional income:		
(a) Business income increased	$3,044.96	
(b) Capital loss reduced	2,121.53	
(c) Income from partnerships	70,309.80	
(d) Income from other sources	53,287.50	
Total	$128,763.79	
Additional deduction:		
(e) Contributions	6,110.75	
Net addition to income		122,653.04
Net income adjusted		$274,274.71

Schedule 1-A

Explanation of Adjustments

(a) Business income reported has been increased, as follows:

Collection on oil payment omitted	$60.03
Repairs to personal residence and boathouse, disallowed	1,116.24
Excessive depreciation on lease equipment	2,321.34
Additional depletion allowed	(452.65)
Net Adjustment	$3,044.96

[fol. 242] (b) Capital loss reported has been reduced by the net of the following items:

Sherman Oil & Gas Company stock sold (Basis of ½ reduced to estate tax valuation)	$425.00
Socony-Vacuum gain reduced	(4.60)
Fleming Oil Company (Exhibit A) ½ of both interests	893.85
Fleming and Kimball, gain	807.28
Net adjustment	$2,121.53

(c) Ordinary income reported from partnerhips has been increased, as follows:

Fleming & Kimball:		
As corrected	$17,647.72	
Reported	15,573.12	
Increase		$2,074.60
Fleming Oil Company:		
As corrected (Exhibit A)—		
Salary	$12,500.00	
Wm. Fleming	65,370.39	
Estate	65,370.39	
Total	$143,240.78	
Reported	75,005.58	
Increase		$68,235.20
Eddleman Oil Company (not changed)		
Total increase		$70,309.80

[fol. 243] (d) Your gain on the exchange of an oil payment, face amount $73,500.00, plus 5% interest payable out of 40% of 41.667 W.I. in State (Choate) Lease, Eddy County, New Mexico, for a ¼ undivided interest in 2.994½ acres in Parker and Tarrant Counties, Texas, has been computed as follows:

Consideration, fair market value of land received, held to be face value of oil payments—	
¼ of $294,000.00	$73,500.00
Cost basis of oil payment assigned, depletion, 27½ of $73,500.00	20,212.50
Income increased	$53,287.50

(e) The entire amount of contributions, $32,867.52, is allowable after above adjustments are applied to adjusted gross income, instead of $26,756.77 per return on additional deduction of the difference, $6,110.75.

Schedule 2

Computation of Tax

Net income		$274,274.71
Less: Exemptions (3 x $600)		1,800.00
Income subject to tentative tax		$272,474.71
½ of $272,474.71, joint return		$136,237.36
Tentative tax		$99,571.25 (1)
Tax reduction:		
$68 plus 12% of $99,171.25		11,968.55 (2)
[fol. 244]		
Combined normal tax and surtax, (1) minus (2)		$87,602.70
Multiply $87,602.70 by 2, for tax liability		$175,205.40
Income tax liability disclosed by return, Account #3194733		81,092.10
Deficiency in income tax		$94,113.30

Schedule 3

Taxable Year Ended December 31, 1949

Adjustments to Net Income

Net income as disclosed by joint return		$64,597.92
Unallowable deductions and additional income:		
(a) Business income increased	$1,706.51	
(b) Capital loss reduced	31.19	
(c) Income from partnerships	1,017.24	
Total	$2,754.94	
Nontaxable income and additional deductions:		
(d) Contributions	413.25	
Net addition		2,341.69
Net income adjusted		$66,939.61

[fol. 245] Schedule 3-A

Explanation of Adjustments

(a) Omission in summary on return:		
Collection oil payments, page 19	$8,613 13	
Carried to summary	6,007 65	$2,605 48
Repairs, 75% of $1,775.34 claimed is disallowed as repairs, being a capital expenditure		1,331 50
Repairs to residence and boathouse		1,616 56
Loss on sale of cars for personal use		1,639 50
Excessive depreciation		1,755 34
Additional depletion		(7,241 87)
Net adjustment		$1,706 51

(b) Loss on sale of capital assets is decreased by your distributive share of the gain of Fleming and Kimball, $62.38, of which 50%, or $31.19, is taken into account.

(c) Ordinary net income from partnerships reported in your return has been increased as follows:

Fleming and Kimball:		
As corrected	$13,090 14	
Reported	11,628 04	$1,462 1[illegible]
Fleming Oil Company:		
As corrected, Exhibit B—		
Salary	$12,500 00	
Wm. Fleming	11,647 76	
Estate	11,647 76	
Total	$35,795 52	
[fol. 246]		
Reported	36,120 36	
Overstated		(324 84)
Eddleman Oil (No change)		
Fleming Ranch Company		(120 02)
Net addition		$1,017 24

(d) An additional deduction for contributions is allowed, as follows:

Total contributions, $125,370.86.	
Adjusted gross income per return	$75,997 55
Adjustments (a), (b), and (e) above	2,754 94
Total	$78,752 49
Amount allowable, 15% of $78,752.49	$11,812 88
Amount claimed	11,399 63
Additional deduction	$413 25

Schedule 4

Computation of Tax

Net income from Schedule 3	$66,939 61
Less: Exemptions (3 x $600)	1,800 00
Income subject to tentative tax	$65,139 61
½ of $65,139.61, joint return	$32,569 81
Tentative tax	$14,830 38 (1)
Tax reduction:	
$68 plus 12% of $14,430.38	1,799 65 (2)

[fol. 247]

Combined normal tax and surtax, (1) minus (2)	$13,030 73
Multiply $13,030.73 by 2 for tax liability	$26,061 46
Income tax liability disclosed by return, Account # B B/R 1	24,753 76
Deficiency in income tax	$1,307 70

Exhibit A

Fleming Oil Company—1948

	Capital Gain	Ordinary Income	Total
Net income per return	$2,870 44	$112,054 06	$114,924 50
Additions:			
(a) Development and production expenses capitalized		1,232 50	
(b) Depreciation disallowed		131 01	
(c) Depletion disallowed		6,745 28	
(d) Gain on sale of equipment	58 98		
(e) Oil payment		106,575 00	
Total additions	$58 98	$114,683 79	$114,742 77
Corrected net income	$2,929 42	$226,737 85	$229,667 27
Less: Salary to Wm. Fleming		12,500 00	12,500 00
Income to be distributed	$2,929 42	$214,237 85	$217,167 27

[fol. 248]

Distribution:

	Percentage	Capital Gain	Ordinary Income	Total
Wm. Fleming	30.513%	$893 85	$65,370 39	$66,264 24
Estate, A. M. Fleming	30.513%	893 85	65,370 39	66,264 24
Wm. Fleming, Trustee	38.974%	1,141 72	83,497 07	84,638 79
Totals	100%	$2,929 42	$214,237 85	$217,167 27

Contributions:

Wm. Fleming	$310 01
Estate, A. M. Fleming	310 01
Wm. Fleming, Trustee	395 98
Total	$1,016 00

Exhibit B

Fleming Oil Company—Year 1949

Net income per return		$51,205.40
Addition:		
Development expense	$425.00	
Additional deductions:		
Depreciation	$306.97	
Loss on sales	260.45	
Fleming Ranch income overstated	240.00	
Depletion	149.88	
Total additional deductions	$957.30	
[fol. 249]		
Net deduction		532.30
Net income as corrected		$50,673.10
Salary to Wm. Fleming		12,500.00
Amount to be distributed		$38,173.10

Distribution:

	Rate	Amount	Contributions per Returns
Wm. Fleming	30.513%	$11,647.76	$855.13
Estate of A. M. Fleming	30.513%	11,647.76	855.13
Wm. Fleming, Trustee	38.974%	14,877.58	1,092.24
Totals	100%	$38,173.10	$2,802.50

IN THE TAX COURT OF THE UNITED STATES

Docket No. 46781

F. HOWARD WALSH and MARY D. WALSH (Husband and Wife) Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION—Filed February 5, 1953

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency

(Bureau Symbols Dallas-IRA:90D-H) dated November 10, 1952, and as a basis for their proceeding allege as follows:

[fol. 250]

I

The petitioners are individuals. They are now, and were at all pertinent times hereafter referred to, husband and wife. They reside in Fort Worth, Texas, and their office is at 1701 Fair Building, Fort Worth, Texas. The returns for the periods here involved were filed with the Collector of Internal Revenue of the Second Collection District of Texas at Dallas, Texas.

II

The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioners on November 10, 1952.

III

The deficiencies, as determined by the respondent, are in income taxes for the calendar years 1948 and 1949, in the amounts of $2,301.31 and $38,550.52, respectively, substantially all of which is in dispute.

IV

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(b) The respondent erroneously failed to determine that [fol. 251] petitioners' gain from the exchange of certain limited overriding royalty interests in oil and gas leaseholds for urban real estate was within the purview of Section 112(b)(1) of the Internal Revenue Code, so that said gain was not to be recognized in determining petitioners' taxable income for 1949.

(c) Alternatively, the respondent erred in failing to determine that the gain from the exchange, referred to in subparagraph (b) above, was taxable as long-term capital gain, rather than as ordinary income subject to depletion.

(d) Respondent erroneously determined the income of Wm. Fleming, Trustee for the fiscal years of said Trust ended August 31, 1948, and August 31, 1949, and therefore erroneously determined the share of said income taxable to petitioners for the calendar years 1948 and 1949.

V

The facts upon which the petitioners rely as the basis for this proceeding are as follows:

(a) Throughout the applicable periods herein referred to petitioners were husband and wife, residing together in Fort Worth, Texas. They kept their books and records upon the cash receipt and disbursement basis and duly filed joint income tax returns for the calendar years 1948 and 1949 upon that basis, and for calendar year periods.

(b) Throughout the years 1948 and 1949, petitioner, Mary D. Walsh, was the beneficiary of a Trust known as Wm. Fleming, Trustee, of which Wm. Fleming, 1218 Fair [fol. 252] Building, Forth Worth, Texas, was the Trustee. This Trust kept its books and records upon the cash receipt and disbursement basis and upon the basis of a fiscal year ending on August 31. It duly filed income tax returns as a fiduciary with the Collector of Internal Revenue for the Second Collection District of Texas for the fiscal years ending August 31, 1948 and August 31, 1949. These returns were filed upon such cash receipt and disbursement basis.

[fol. 253] (c) On October 5, 1949, the petitioners owned ordinary commercial oil and gas leases and the leasehold estates conveyed thereby, or interests therein, in and with respect to various lands in Ward County, Texas. These interests, and each of them, had been owned by petitioners for more than six months prior to said date of October 5, 1949, and during all of that time had been held by petitioners for productive use in their trade or business of producing oil and gas, and not as stock in trade or primarily for sale. On said date, to wit, October 5, 1949, petitioners conveyed to one C. C. Cross limited overriding royalty or oil payment interests out of said leases and leaseholds, by virtue of which the said C. C. Cross became the owner of 1/4th of 7/8ths of the oil and gas then under said lands, and each of them, except as to one tract as to which the fractional interest was 1/4th of 7/16ths, and of the same part [fol. 254] of the oil and gas thereafter to be produced from said lands until he, the said C. C. Cross, had received oil and gas of a value of $65,000, plus an amount equal to that which interest would produce when calculated at the rate of 7 per cent per annum on the amount of said sum of

$65,000 remaining from month to month unsatisfied. Petitioners received as the sole and only consideration for the limited overriding royalty interest so transferred, and in exchange therefor, improved real estate located in Tarrant County, Texas. Petitioners acquired said Tarrant County real estate for investment and have continued to hold the same for investment since it was so acquired.

(f) Being advised and believing that the gain from the aforesaid exchange was not to be recognized in determining their income for 1949, because of the provisions of Section 112(b)(1) of the Internal Revenue Code, petitioners reported no gain or loss from said transaction in their income tax return for the year 1949. Upon an investigation of said 1949 tax return, the respondent made the following determinations:

1. That the market value of said Tarrant County real estate on October 5, 1949, was $65,000.

2. That the limited overriding royalty interests, so transferred to the said C. C. Cross, had no cost or basis in the hands of the petitioners.

3. That said sum of $65,000 constituted a part of petitioners' gross income from the leaseholds, from which the overriding royalties came, as to which petitioners were entitled to an allowance for depletion equal to 27½ per cent of said amount, or $17,875.

[fol. 255] 4. That petitioners' net income from said exchange was $47,125.

(g) In accordance with the determinations set out in the preceding Subparagraph (f), respondent increased the taxable income of petitioners for the year 1949 in the amount of $47,125. A substantial portion of the deficiency asserted against the petitioners for the year 1949, and here involved, results from this action.

(h) Petitioners allege upon information and belief that the respondent erred in determining that the gain of petitioners from the aforesaid exchange was to be recognized in determining their taxable income for the year 1949. Petitioners further allege upon information and belief that the said exchange constituted an exchange of properties of a like kind within the purview of Section 112(b)(1) of

the Internal Revenue Code, and that none of the excepting provisions of said section applies to said exchange.

(i) Alternatively, petitioners say that if they be mistaken in the position heretofore advanced that said exchange came within the non-recognition of gain provisions of Section 112(b)(1) of the Internal Revenue Code, then the gain resulting to petitioners from the said transaction was long-term capital gain derived from the exchange of capital assets within the purview of Section 117 of the Internal Revenue Code, and the respondent erred in failing so to hold in determining the deficiencies here involved.

(j) There was distributed to petitioner, Mary D. Walsh, by Wm. Fleming, Trustee aforesaid in the year 1948, and from the income of said Trust for its fiscal year ended Au- [fol. 256] gust 31, 1948, the sum of $10,000; and there was likewise distributed to said petitioner, Mary D. Walsh, from the income of said Trust for its fiscal year ended August 31, 1949, and during the year 1949, the sum of $27,000. The respondent has determined the deductions for depletion and depreciation allowable to petitioners with respect to said distributions, and the portions thereof taxable to petitioners as capital gain on the basis of his determinations of the net taxable income of said Trust for its fiscal years ended August 31, 1948, and August 31, 1949. The correctness of these determinations, as to the income of said Trust for these periods, is in issue in a proceeding which has been heretofore filed in this Court, or will shortly hereafter be filed in this Court, from a notice of transferee liability mailed to petitioner, Mary D. Walsh, on November 2, 1952. Petitioners say that the proper treatment of said distributions, in determining the tax-liability of these petitioners can only be determined after the net income of said Trust for said two fiscal periods has been determined. The petition filed, or to be filed, in said transferee proceeding is incorporated herein by reference.

Wherefore, the petitioners pray that this Court may hear the proceeding, and upon such hearing hold and determine:

(b) That the aforesaid exchange gave rise to gain which was not to be recognized because of the provisions of Section 112(b)(1) of the Internal Revenue Code.

[fol. 257] (c) Alternatively, that the gain resulting from the aforesaid exchange was taxable as long-term capital gain under Section 117 of the Internal Revenue Code; and

(d) That their incomes for 1948 and 1949 from Wm. Fleming, Trustee be adjusted to conform with the final determinations of taxable income made in the aforesaid transferee proceeding; and that they have such other and further relief as they may be entitled to receive under the facts alleged.

Harry C. Weeks, Counsel for Petitioners.

525 Fort Worth National Bank Building, Fort Worth, Texas.

Of Counsel: Weeks, Bird, Cannon & Appleman, Fort Worth, Texas.

State of Texas,
County of Tarrant:

F. Howard Walsh and Mary D. Walsh, being each duly sworn, say that they are the petitioners above named; that each has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those each believes to be true.

Mar D. Walsh, (F. Howard Walsh), Mary D. Walsh.

[fol. 258] Sworn to and subscribed before me this the 31st day of January, A. D. 1953.

Marguerite Shepherd, Notary Public in and for Tarrant County, Texas. (Seal.)

EXHIBIT A TO PETITION

U. S. Treasury Department

Office of Internal Revenue Agent in Charge, Mercantile Commerce Building, Dallas 1, Texas.

Dallas
IRA:90D-H

Nov. 10, 1952

Mr. F. Howard Walsh, and Mrs. Mary D. Walsh, Husband and Wife, 1701 Fair Building, Fort Worth, Texas.

DEAR MR. AND MRS. WALSH:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948 and 1949 discloses a deficiency of $2,301.31 and $38,550.52, respectively, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

[fol. 259] Within 90 days from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of C:RLP. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours, John B. Dunlap, Commissioner, By A. H. Hertwig, Acting Internal Revenue Agent in Charge.

Enclosures: Statement, Form 1276, Agreement Form, GN:esk.

[fol. 260] Statement

Mr. F. Toward Walsh, and Mrs. Mary D. Walsh, Husband and wife, 1710 Fair Building, Fort Worth, Texas.

Income Tax Liability for the Taxable Years Ended December 31, 1948 and 1949

Year	Deficiency
1948	$ 2,301.31
1949	38,550.52
Total	$40,851.83

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated September 5, 1951; to your protest dated January 17, 1952; and to the statements made at the conference held on April 2, 1952.

A copy of this letter and statement has been mailed to your representative, Mr. Harry C. Weeks, Fort Worth National Bank Building, Fort Worth, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Schedule 1

Taxable Year Ended December 31, 1948.
Adjustments to Net Income.

Net income as disclosed by joint return		$97,513.72
[fol. 261]		
Unallowable deductions and additional income:		
(a) Interest income	$2,872.10	
(b) Capital gain	8,226.29	
(c) Partnership income	858.40	
Total	$11,956.79	
Additional deduction:		
(d) Trust income overstated	6,590.08	
Net addition		5,366.71
Net income adjusted		$102,880.43

Schedule 1-A

Explanation of Adjustments

(a) It is held that you received taxable income from contracts with life insurance companies, as follows:

1. Pan-American Life Insurance Company (Policy #274-057) paid	$ 739.92
2. Southwestern Life Insurance Company (Deferred payment agreements #462429-T and #484414) credited	2,132.18
Total	$2,872.10

1. Before maturity of a 10-year endowment policy, Mrs. Walsh (then Mary D. Fleming) executed a settlement agreement under which the company was to retain the net proceeds for a period not exceeding 30 years with interest at a rate not less than 3% per annum to be paid Mrs. [fol. 262] Walsh monthly. The net proceeds of the policy were to be paid to her executors upon her death or to her if she lived through the 30-year period. The amount received in 1948, $739.92, was omitted from taxable income on your return and is therefore, included here.

2. On July 13, 1943 after maturity date November 2, 1942 of a single-premium endowment policy, Mrs. Walsh entered into a contract for deferment of payment in which the company guaranteed an addition to the policy of not less than 3½% per annum on the unpaid portion of the proceeds until November 2, 1952 and thereafter payment monthly to Mrs. Walsh of such interest as it accrued. The amount accrued and credited to this policy in 1948, $2,132.18, is included in income.

(b) Capital gain distributed to Mrs. Walsh from Wm. Fleming Trust. See Exhibit A. Capital gains received and omitted, $8,226.29.

(c) Your share of income from the partnership, Walsh and Watts, was found to be $22,538.93 instead of $21,680.53, an additional amount of $858.40.

(d) Ordinary income from Wm. Fleming, Trustee, has been adjusted to accord with Exhibit A.

Amount reported	$8,165.73
Amount, Exhibit A	1,575.65
Reduction in taxable income	$6,590.08

[fol. 263] Schedule 2

Computation of Income Tax

Adjusted net income	$102,880.43
Less: Exemptions (6 x 600)	3,600.00
Income subject to tentative tax	$ 99,280.43
½ of $99,280.43, joint return	$ 49,640.22
Tentative normal tax and surtax	$ 26,560.96
Less: $68 plus 12% of excess tax over $400.00	3,207.32
Combined normal tax and surtax	$ 23,353.64
Multiply $23,353.64 by 2 for joint return	$ 46,707.28
Alternative tax, Schedule 3	$ 45,418.49
Income tax previously assessed	43,117.18
Deficiency in income tax	$ 2,301.31

Schedule 3

Computation of Alternative Tax

Income subject to tentative tax, ½	$ 49,640.22
Less: 50% excess of net long-term capital gain, over short-term capital losses ($9,646.69)	4,823.35
Balance taxable	$ 44,816.87
Tentative Tax	$ 23,088.15
Less: $68 plus 12% of excess over $400.00	2,790.58
Combined partial normal and surtax	$ 20,297.57
Multiply $20,297.57 by 2, joint return	$ 40,595.14
Add: 50% excess of net long-term capital gain over short-term and capital losses	4,823.35
Alternative tax, to Schedule 2	$ 45,418.49

[fol. 264] Schedule 4

Taxable Year Ended December 31, 1949

Adjustments to Net Income

Net income as disclosed by joint return		$141,593.89
Unallowable deductions and additional income:		
(a) Interest	$2,946.73	
(b) Rents	528.87	
(c) Ordinary income from trust	2,029.25	
(d) Other income	47,125.00	52,629.85
Net income adjusted		$194,223.74

Schedule 4-A

Explanation of Adjustments

(a) It is held that in 1949 as in 1948 (see Schedule 1-A (a) for explanation), you received taxable income from contracts with life insurance companies. The amounts paid or credited in 1949 are as shown below:

Pan-American Life Insurance Company, paid to you	$ 739.92
Southwestern Life Insurance Company, credited to you	2,206.81
Total	$ 2,946.73

(b) Rental income has been increased by the net of the following adjustments:

[fol. 265] Capital items (abstract, taxes accrued at date of purchase, etc.)	$ 534.41
Insurance premium applicable to 1950 and 1951, disallowed	548.98
Total	$ 1,083.39
Depreciation allowed (4% on $55,452.11 3 months)	554.52
Net addition to income	$ 528.87

(c) Income received from Wm. Fleming, Trustee, is adjusted per Exhibit A.

Ordinary income	$ 21,843.11
Per return	19,813.86
Addition	$ 2,029.25

Note: The capital gain of $98.06 shown on Exhibit A reduces the capital loss carry-over to 1950 by that amount.

(d) It is held that the execution of an oil payment contract in the amount of $65,000.00 to Mrs. C. C. Cross in exchange for land and improvements of a like value resulted in taxable income to you. The amount shown was payable out of 1/4 of 7/8 production from the Ward County leases known as—

Walsh's Richter A, B & C Leases (4 20-acre tracts)
Walsh's Green Lease
Walsh's Maxwell A Lease
Walsh's Maxwell B Lease
Walsh's Wallis Lease

[fol. 266] Also, out of 1/4 of 7/16 of production on Walsh's Killough Lease, also in Ward County.

Since your costs of these leases had been recovered through depletion prior to sale, there is no cost involved in the following computation.

Consideration	$ 65,000.00
Depletion at 27½%	17,785.00
Taxable income	$ 47,125.00

Schedule 5

Computation of Tax

Adjusted net income	$194,223.74
Less: Exemptions (6 x $600)	3,600.00
Income subject to tax	$190,623.74
½ of $190,623.74, joint return	$ 95,311.87
Tentative Tax	$ 63,241.33
Less: $68 plus 12% of excess over $400.00	7,608.96
Combined normal tax and surtax	$ 55,632.37
Multiply $55,632.37 by 2 for tax liability	$111,264.74
Income tax per return, Account #BF 308	72,714.22
Deficiency in income tax	$ 38,550.52

[fol. 267]

EXHIBIT A

Adjustments to Net Income

	Year Ended August 31, 1948				Year Ended August 31, 1949			
	Per Return 8-31-1948		Additions to Income (Deductions)	Corrected	Per Return 8-31-1949		Additions to Income (Deductions)	Corrected
Dividends and interest	$2,550.00			$2,550.00	$4,775.00			$4,775.00
Partnership income	83,959.72	(a)	$2,116.94	86,076.66	42,380.84	(a)	$43,062.17	85,443.01
Sale of equipment	(20.60)			(20.60)				
Capital gains	681,013.28	(b)	13,846.62	694,859.90		(b)	570.86	570.86
Business	8,051.35			8,051.35	66,387.86			66,387.86
Other sources		(c)	53,165.03	53,165.03				
Total income	$775,553.75		$69,128.59	$844,682.34	$113,543.70		$43,633.03	$157,176.73
Depletion	$16,827.50	(d)	$496.93	$16,330.57	$26,956.54	(c)	$665.33	$26,291.21
Depreciation	390.82			390.82	3,158.11			3,158.11
Other deductions	670.16	(e)	670.16		395.98	(d)	395.98	
Total deductions	$17,888.48		$1,167.09	$16,721.39	$30,510.63		$1,061.31	$29,449.32
Remainder of income	$757,665.27		$70,295.68	$827,960.95	$83,033.07		$44,694.34	$127,727.41
Distributions	(8,165.73)	(f)	(1,636.21)	(9,801.94)	(19,813.86)	(e)	(2,127.31)	(21,941.17)
Net income	$749,499.54		$68,659.47	$818,159.01	$63,219.21		$42,567.03	$105,786.24

EXHIBIT A—Continued

Explanation—Year 1948

(a) Ordinary income from the partnership Fleming Oil Company increased as agreed by partners for calendar year year 1947, $2,116.94.

(b) Capital gains of Fleming Oil Company increased as agreed to by the partners, year 1947, 3,846.62.

(c) Exchange of royalty interests for 2,994½ A. of land—Gain $53,287.50
Less Loss by death of cattle 122.47
Net increase in income $53,165.03

(d) Depletion claimed was excessive by $496.93.

(e) Contributions are considered in (a), $670.16.

(f) Distribution $10,000.00. Ratio of total income, $844,682.34, to net income of $827,900.95 is .980194. Therefore, amount of taxable distribution is $9,801.94.

Capital gain	$8,226.29
Ordinary income	1,575.65
Total	$9,801.94

Explanation—Year 1949

(a) Ordinary income from Fleming Oil Company

Ordinary income	$83,497.07
Per return	39,918.92
Additional income	$43,578.15
Fleming Ranch Company, income reduced	120.00
Net increase	$43,458.15
Less: Contributions	395.98
Adjustment	$43,062.17

(b) Capital gain Fleming Oil Company, $1,141.72. Amount taxable, 5%, $570.86.

(c) Excessive depletion, $665.33.

(d) Contributions in (a) above.

(e) Net income, $127,727.41, is 81.26358% of total income, $157,176.73; amount of distributions ($27,000.00) deductible is 81.26358% of $27,000, or $21,941.17.

Capital gain	$98.06
Ordinary income	21,843.11
Total	$21,941.17

[fol. 268] IN THE TAX COURT OF THE UNITED STATES.

Docket No. 46782

MARY D. FLEMING WALSH, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION—Filed Feb. 5, 1953

The above-named petitioner hereby petitions for a redetermination of the deficiency or alleged liability as a transferee set forth by the Commissioner of Internal Revenue in his notice of deficiency and alleged transferee liability (Bureau symbols Dallas—IRA: 90D—D), dated November 10, 1952, and as a basis of her proceedings alleges as follows:

1

The petitioner is an individual. She resides in Fort Worth, Texas, and her office is at 1701 Fair Building, Fort Worth, Texas. The returns of her alleged transferor for the periods here involved were filed with the Collector of Internal Revenue for the Second Collection District, at Dallas, Texas.

2

The notice of deficiency and alleged transferee liability (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on November 10, 1952.

[fol. 269] 3

The deficiency as determined by the respondent is in income tax claimed to be due by Wm. Fleming, Trustee, for its fiscal years ended August 31, 1948 and August 31, 1949, in the amounts of $51,976.17 and $31,218.55, respectively, and the transferee liability asserted is against petitioner as the alleged transferee of the assets of Wm. Fleming, Trustee.

4

The determination of the tax liability of Wm. Fleming, Trustee, set forth in said notice of deficiency is based on the following errors:

(a) The respondent erroneously failed to determine that the gain derived by Wm. Fleming, Trustee, from the exchange of certain limited overriding royalty interests in oil and gas leaseholds for an undivided interest (in fee simple) in ranch lands was within the provisions of Section 112(b)(1) of the Internal Revenue Code, so that the said gain was not to be recognized in determining the taxable income of Wm. Fleming, Trustee, for its fiscal year ended August 31, 1948.

(b) The respondent erroneously failed to determine that the gain derived by a partnership (Fleming Oil Company), of which Wm. Fleming, Trustee, was a member, from the exchange of certain limited overriding royalty interests in oil and gas leaseholds for an undivided interest (in fee simple) in ranch lands came within the provisions of Section 112(b)(1) of the Internal Revenue Code, so that the [fol. 270] said gain was not to be recognized in determining the net income of said partnership for the calendar year 1948, and in determining the distributive share of said partnership income upon which Wm. Fleming, Trustee, was to be taxed in its fiscal year ended August 31, 1949.

(c) Alternatively, the respondent erred in failing to determine that the gain from the exchanges referred to in sub-paragraphs (a) and (b), above, was taxable as long-term capital gain, rather than as ordinary income subject to depletion.

The determination of transferee liability set forth in said notice of deficiency is based on the erroneous determination by the respondent that petitioner was liable as a transferee, for the deficiencies in income tax so asserted against Wm. Fleming, a trustee, in said notice.

5

The fact on which the petitioner relies as a basis of her proceeding are as follows:

(a) Petitioner at all pertinent times involved herein was the beneficiary of a trust known as, "Wm. Fleming,

Trustee," of which Wm. Fleming, 1218 Fair Building, Fort Worth, Texas, was the trustee. Said trust kept its books and records on the cash receipts and disbursements basis, and for fiscal year periods ending on August 31. It duly filed income tax returns for its fiscal years ended August 31, 1948 and August 31, 1949, on the cash receipts and disbursements basis, and for such fiscal-year periods.

[fol. 271] (b) Throughout the fiscal years of Wm. Fleming, Trustee, ended August 31, 1948 and August 31, 1949 as well as prior and subsequent thereto, there existed a partnership known as Fleming Oil Company, which had its office and place of business at 1218 Fair Building, Fort Worth, Texas. The said trust was a member of this partnership. This partnership was engaged primarily in the business of acquiring, developing and operating oil and gas properties, but, from time to time, made other investments. This partnership kept its books and records on the cash receipts and disbursements basis and accounted for calendar-year periods, and it duly filed income tax returns on such basis and for such periods. At all of the times involved in this proceeding, the interest of Wm. Fleming, Trustee, in said partnership was 38.974%.

(c) On May 19, 1948, the said partnership Fleming Oil Company owned ordinary commercial oil and gas leases, or interests therein, on lands located in Texas. These leaseholds were known as the Denman "C" Lease, the Denman "H" Lease, the Reid "A" and "B" Leases, and the Snyder "C" Lease, all on lands located in Howard County, Texas. The said partnership had on that date, May 19, 1948, owned said leaseholds and interests therein, and each of them, for several years, during all of which time they were held by said partnership for productive use in its trade or business, and not as stock in trade or primarily for sale.

(d) On May 19, 1948, Fleming Oil Company aforesaid conveyed to Mrs. Marie Hildreth Cline, limited overriding royalty or oil payment interests from the leasehold interest described in the foregoing subparagraph (c), by virtue of [fol. 272] which she, the said Marie Hildreth Cline, became the owner of fractional parts of the oil and gas then under the said lands, and became entitled to receive, sell and dispose of the same, when, as and if produced, until she had received from this source oil and gas of the value of

$147,000, plus an amount equal to that which interest would produce when calculated at the rate of 5% per annum upon the amount of said $147,000 remaining from month to month unsatisfied. The fractional interest so conveyed in each and all of said leases was 1/2 of 7/8ths, except as to the Denman "H" Lease, as to which the fractional interest conveyed from 1/2 of 13 16ths. Fleming Oil Company received from the said Marie Hildreth Cline, as the sole consideration for the properties so conveyed to her, an undivided 50% fee simple interest in approximately 2,994.5 acres of ranch lands in Parker and Tarrant Counties, Texas, this ranch being known as the Cline Ranch. Said partnership acquired the said interest in said Cline Ranch for investment, and has continued to hold the same for that purpose since it was so acquired.

(e) Being advised and believing that the gain from the aforesaid exchange was not to be recognized in determining its income for the year 1948 because of the provisions of Section 112 (b)(1) of the Internal Revenue Code, Fleming Oil Company reported no gain or loss from said transaction in its income tax return for the year 1948. Upon an investigation of said partnership return and the return of Wm. Fleming, Trustee for its fiscal year ended August 31, 1949, the respondent made the following determinations:

(1) That the market value of said 50% interest in said Cline Ranch on May 19, 1948 was $147,000.

[fol. 273] (2) That the net basis in the hands of said partnership for the interests in said oil and gas leases so conveyed to Marie Hildreth Cline was $1,102.70.

(3) That said $147,000 (the value of a 50% undivided interest in said Cline Ranch, constituted ordinary income of Fleming Oil Company for the calendar year 1948.

(4) That the aforesaid amount of $147,000 represented income from the respective oil and gas leases heretofore referred to, so that said partnership was entitled to deduct an allowance for depletion equal to 27 1/2% of said gross income, or $40,425.

(5) That said partnership's net income from said exchange was $106,575.

(f) In accordance with the determination set out in the preceding subparagraph (e), the respondent increased the taxable income of said partnership for the year 1948

in the amount of $106,575 and added a ratable portion thereof (38.974%) to the taxable income of Wm. Fleming, Trustee for the fiscal year ended August 31, 1948, as otherwise adjusted. A substantial portion of the deficiency so determined in Exhibit A attached hereto against Wm. Fleming, Trustee for its fiscal year ended August 31, 1949, results from this action.

(g) On May 19, 1948, Wm. Fleming, Trustee was, among other business activities, engaged in the business of acquiring oil and gas properties, developing them, and producing oil and gas therefrom. On that date, Wm. Fleming, Trustee owned an interest in an ordinary commercial [fol. 274] oil and gas lease, and the leasehold estate conveyed thereby, covering lands in Gregg County, Texas, known as the J. M. Christian Lease, and also owned a mineral or royalty interest on lands in Cook County, Texas, known as the Ramsey Royalty. Wm. Fleming, Trustee had owned these properties for several years prior to May 19, 1948, during all of which time they had been held for productive use in said trust's trade or business or producing oil and gas, and not as stock in trade and not primarily for sale. On said date, the said Wm. Fleming, Trustee conveyed to the aforesaid Marie Hildreth Cline limited overriding royalty interests in the above described properties by which she, the said Marie Hildreth Cline, became the owner of 6 10ths of 1 10ths of 7sths of the oil and gas in and under said J. M. Christian leaseholds and thereafter to be produced from same, until she had received oil and gas of the value of $49,000, plus an amount equal to that which interest would produce when calculated at the rate of five per cent per annum on the said amount of $49,000 remaining from month to month unsatisfied, and by which she, the said Marie Hildreth Cline, became the owner of 32.335 400ths of 1/2 of 1/8th of the oil and gas in and under the lands covered by said Ramsey Royalty and thereafter to be produced from same, until she had received oil and gas of the value of $24,500, plus an amount equal to that which interest would produce when calculated at the rate of five per cent on the said amount of $24,500 remaining from month to month unsatisfied. As the sole consideration for said transfer, the said Marie Hildreth Cline conveyed to Wm. Fleming, Trustee an undivided 1/4th fee simple interest in the aforesaid Cline Ranch. Wm. Fleming,

Trustee acquired said undivided interest in said Ranch for investment, and continued to hold the same solely for that purpose until the termination of said trust on November [fol. 275] 30, 1950, after which it was held for investment by petitioner herein.

(h) Being advised and believing that the gain from the aforesaid exchange was not to be recognized in determining the income tax liability of Wm. Fleming, Trustee for its fiscal year ended August 31, 1948, because of the provisions of Section 112(b)(1), of the Internal Revenue——, the trustee of said trust reported no gain or loss from said transaction in the income tax return filed for said trust for the fiscal year ended August 31, 1948. Upon an investigation of said tax return, the respondent made the following determinations:

(1) That an undivided 1/4th fee simple interest in said Cline Ranch had a fair market value on May 19, 1948 of $73,500.

(2) That said sum of $73,500 constituted a part of the gross income of Wm. Fleming, Trustee for its fiscal year ended August 31, 1948 from the aforesaid J. M. Christian and Ramsey Royalty properties.

(3) That Wm. Fleming, Trustee was entited to an allowance for depletion with respect to said sum of $73,500 equal to 27½% thereof, or $20,212.50.

(4) That the interest in said J. M. Christian and Ramsey Royalty properties so conveyed by Wm. Fleming, Trustee to Marie Hildreth Cline had a net cost or basis in the hands of Wm. Fleming, Trustee totaling $18,119.21.

(5) That Wm. Fleming, Trustee derived taxable ordinary income from said exchange of $53,287.50. Accord- [fol. 276] ingly, respondent added said amount of $53,287.50 to the income of Wm. Fleming, Trustee, for the fiscal year ended August 31, 1948, as otherwise adjusted, and a substantial portion of the deficiency determined to be due by Wm. Fleming, Trustee for that fiscal year, as shown in Exhibit A attached hereto, is based upon this determination.

(i) Petitioner alleges, upon information and belief, that the respondent erred in determining that the gain of the partnership Fleming Oil Company and of Wm. Fleming, Trustee from the aforesaid exchanges was to be recognized

in determining the income of said partnership for the year 1948 and in determining the income of Wm. Fleming, Trustee for its fiscal years ended August 31, 1948 and 1949. Petitioner further alleges, upon information and belief, that said exchanges, and each of them, constituted exchanges of property of like kind within the provisions of Section 112(b)(1) of the Internal Revenue Code, and that none of the excepting provisions of said section applies to either of said exchanges.

(j) Alternatively, petitioner says that, if she be mistaken in the position heretofore advanced, that said exchanges and each of them came within the non-recognition-of-gain provisions of Section 112(b)(1), of the Internal Revenue Code; then the gain so resulting to said partnership and to Wm. Fleming, Trustee from said transactions was taxable as long-term capital gain derived from the exchange of capital assets within the purview of Section 117 of the Internal Revenue Code, and the respondent erred in failing so to hold in determining the deficiencies asserted against Wm. Fleming, Trustee, as shown in Exhibit A hereto attached.

[fol. 277] Wherefore, the petitioner prays that this Court may hear the proceeding and, on such hearing, hold and determine (a) that the aforesaid exchanges and each of them gave rise to gain which was not to be recognized because of the provisions of Section 112(b)(1) of the Internal Revenue Code; or, alternatively (b) that the gain resulting from the aforesaid exchanges, and each of them, was taxable as long-term capital gain under Section 117 of the Internal Revenue Code; and (c) that the petitioner is not liable for the deficiencies determined against Wm. Fleming, Trustee, and that she may have such other and further relief as she may be entitled to receive under the facts alleged.

Harry C. Weeks, Attorney for Petitioner.

525 Fort Worth National Building,
Fort Worth, Texas.

Of Counsel: Weeks, Bird, Cannon & Appleman, Fort Worth, Texas.

STATE OF TEXAS,
County of Tarrant:

Mary D. Fleming Walsh, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those she believes to be true.

Mary D. Fleming Walsh.

[fol. 278] Subscribed and sworn to before me, this 31st day of January, 1953.

Marguerite Shepherd, Notary Public in and for Tarrant County, Texas. (Seal.)

(Copy)

EXHIBIT "A" TO PETITION

U. S. Treasury Department

Office of Internal Revenue Agent in Charge, Mercantile-Commerce Building, Dallas 1, Texas

Dallas
IRA:90D-D

November 10, 1952.

Mrs. Mary D. Fleming Walsh, 1701 Fair Building, Fort Worth, Texas.

DEAR MRS. WALSH:

You are advised that the determination of the income tax liability of Wm. Fleming, Trustee, 1218 Fair Building, Fort Worth, Texas, for the taxable years ended August 31, 1948, 1949, and 1950, discloses deficiencies of $51,976.17 and $31,218.55, respectively, for the taxable years ended August 31, 1948 and 1949, and an overassignment of $218.27 for the taxable year ended August 31, 1950, as shown in the statement attached. The amount of the deficiencies stated, plus interest as provided by law, constituting your liability as

transferee of assets of said Wm. Fleming, Trustee, will [fol. 279] be assessed against you. The overassessment, to the extent that it represents an overpayment of tax, will be credited in the manner provided by law.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of C:RLP. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Yours very truly, John B. Dunlap, Commissioner, by (Signed) E. A. Peavy, Internal Revenue Agent in Charge.

[fol. 280] Enclosures: Statement, Form 1276, Agreement Form, Form 843.

Statement

Wm. Fleming, Trustee, Transferor, 1218 Fair Building, Fort Worth, Texas

Income Tax Liability for the Taxable Years Ended August 31, 1948, 1949 and 1950

Mrs. Mary D. Fleming Walsh, Transferee, 1701 Fair Building, Fort Worth, Texas

Year Ended	Overassessment	Deficiency
August 31, 1948		$51,976 17
August 31, 1949		31,218 55
August 31, 1950	$218 27	
Totals	$218 27	$83,194 72

The records of this office show that assets of the trust, Wm. Fleming, Trustee, were transferred to you in 1950.

The amounts shown above represent your liability as transferee of Wm. Fleming, Trustee, for unpaid income taxes for the fiscal years ended August 31, 1948, 1949 and 1950.

[fol. 281] The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322 of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the collector of internal revenue for your district, a claim for refund on form 843, a copy of which is enclosed, the basis of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Mr. Harry C. Weeks, Fort Worth National Bank Building, Fort Worth, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

The computation of the taxes shown above for which you are liable is set out in the attached schedules.

Schedule 1

Taxable Year Ended August 31, 1948
Adjustments to Net Income

	Per Return 8-31-1948		Additions to income (Deductions)	Corrected
Dividends and interest	$2,550.00			$2,550.00
Partnership income, [fol. 282]	83,959.72	(a)	$2,116.94	86,076.66
Sale of equipment	(20.60)			(20.60)
Capital gains	681,013.28	(b)	13,846.62	694,859.90
Business	8,051.35			8,051.35
Other sources		(c)	53,165.03	53,165.03
Total income	$775,553.75		$69,128.59	$844,682.34
Depletion	$16,827.50	(d)	$496.93	$16,330.57
Depreciation	390.82			390.82
Other deductions	670.16	(e)	670.16	
Total deductions	$17,888.48		$1,167.09	$16,721.39
Remainder of income	$757,665.27		$70,295.68	$827,960.95
Distributions	(8,165.73)	(f)	(1,636.21)	(9,801.94)
Net income	$749,499.54		$68,659.47	$818,159.01

(a) Ordinary income from the partnership, Fleming Oil Company, increased as agreed by partners for calendar year 1947, $2,116.94.

(b) Capital gains of Fleming Oil Company increased as agreed to by the partners, year 1947, $13,846.62.

(c) Exchange of royalty interest for 2,994½ A. of land.

Gain	$53,287.50
Less loss by death of cattle	122.47
Net increase in income	53,165.03

(d) Depletion claimed was excessive by $496.93.

[fol. 283] (e) Contributions are considered in (a), $670.16.

(f) Distribution, $10,000.00; Ratio of total income $844,682.34 to net income of $827,960.95 is .980194. Therefore, amount of taxable distribution is $9,801.94.

Schedule 2

Computation of Income Tax

Adjusted net income	$818,159.01
Less: Excess net long-term capital gain over net short-term capital losses	686,633.61
Net ordinary income	$131,525.40
Less: Exemption	100.00
Balance subject to tax	$131,425.40
Normal and surtax (at 1947 rates)	$ 95,288.61
Less: 5% reduction	4,764.43
Balance	$ 90,524.18
Alternative tax on capital gain (½ of $686,633.61)	343,316.81
Total tax at 1947 rates	$433,804.99
Allocated to 1947 (122/366) .33333	$144,612.22
Normal and surtax (based on 1948 rates)	$ 95,288.61
Less: $68 plus 12% of excess over $400.00	11,454.63
Balance	$ 83,833.98
Alternative tax on capital gain	343,316.81
Total tax at 1948 rates	$427,150.79
[fol. 284] Allocated to 1948 (244/366) .66667	$284,768.62
Total tax (1947 rates)	$144,612.22
Total tax (1948 rates)	284,768.62
Tax liability	$429,380.84
Total tax previously assessed, Account #355003	377,404.67
Deficiency	$ 51,976.17

Schedule 3

Taxable Year Ended August 31, 1949

Adjustments to Net Income

	Per Return 8 31 1949		Additions to income (Deductions)	Corrected
Dividends and interest	$4,775 00			$4,775 00
Partnership income	42,380 84	(a)	$43,062 17	85,443 01
Capital gains		(b)	570 86	570 86
Business	66,387 86			66,387 86
Total income	$113,543 70		$43,633 03	$157,176 73
Depletion	$26,956 54	(c)	$665 33	$26,291 21
Depreciation	3,158 11			3,158 11
Other deductions	395 98	(d)	395 98	
Total deductions	$30,510 63		$1,061 31	$29,449 32
Remainder of income	$83,033 07		$44,694 34	$127,727 41
Distributions	(19,813 86)	(e)	(2,127 31)	(21,941 17)
Net income	$63,219 21		$42,567 03	$105,786 24

[fol. 285] (a) Ordinary income from Fleming Oil Company:

Ordinary income, Exhibit A	$83,497.07
Per return	39,918.92
Additional income	$43,578.15
Fleming Ranch Company, income reduced	120.00
Net increase	$43,458.15
Less: Contributions	395.98
Adjustment	$43,062.17

(b) Capital gain, Fleming Oil Company, per Exhibit A $ 1,141.72
Amount taxable, 5% 570.86

(c) Excessive depletion, $665.33.

(d) Contributions in (a) above.

(e) Net income, $127,727.41, is 81.26358% of total income, $157,176.73. Amount of distributions ($27,000.00) deductible is 81.26358% of $27,000.00, or $21,941.17.

Schedule 4

Computation of Income Tax

Adjusted net taxable income	$105,786.24
Less: Excess of net long-term capital gain over net short-term losses	472.80
Net ordinary income	$105,313.44
Less: Exemption	100.00
[fol. 286] Income for normal tax and surtax	$105,213.44
Total normal and surtax	$ 71,959.96
Less: $68 plus 12% of excess over $400.00	8,655.19
Partial tax	$ 63,304.77
Alternative tax on line 2 above (½ of $472.80)	236.40
Income tax liability	$ 63,541.17
Income tax previously assessed, Account #355005	32,322.62
Deficiency	$ 31,218.55

Schedule 5

Taxable Year Ended August 31, 1950

Adjustments to Net Income

	Per Return 8-31-1950		Additions to income (Deductions)		Corrected
Dividends and interest	$4,188.60				$4,188.60
Partnership income	13,916.11		($1,419.69)	(a)	12,496.42
Business	25,140.33	(b)	(32.01)		25,108.32
Total income	$43,245.04		($1,451.70)		$41,793.34
Other deductions	1,092.24	(c)	1,092.24		
Remainder of income	$42,152.80		(359.46)		$41,793.34
Distributions	None				None
Net income	$42,152.80				$41,793.34

[fol. 287] (a) Income from partnership, Fleming Oil Company:

Per Exhibit B	$14,877.58
Less: Contributions	1,092.24
Net amount	$13,785.34
Fleming Ranch Company, loss as corrected	1,288.93
Corrected amount	$12,496.41

(b) Additional depletion $32.01.
(c) Considered in adjustment (a).

Schedule 6

Computation of Income Tax

Adjusted net income	$41,793.34
Less: Exemption	100.00
Income for normal tax and surtax	$41,693.34
Total normal and surtax	$20,908.40
Less: $68 plus 12% of excess over $400.00	2,529.01
Tax liability	$18,379.39
Tax previously assessed, Account 1950 NOV FT 20	18,597.66
Overassessment	$ 218.27

[fol. 288] EXHIBIT A

Fleming Oil Company—Year 1948

	Capital Gain	Ordinary Income	Total
Net income per return	$2,870 41	$112,054 06	$114,924 50
Additions:			
(a) Development and Production expenses capitalized		1,232 50	
(b) Depreciation disallowed		131 01	
(c) Depletion disallowed		6,745 28	
(d) Gain on sale of equipment	58 98		
(e) Oil payment		106,575 00	
Total additions	$58 98	$114,683 79	$114,742 77
Corrected net income	$2,929 42	$226,737 85	$229,667 27
Less: Salary to Wm. Fleming		12,500 00	12,500 00
Income to be distributed	$2,929 42	$214,237 85	$217,167 27

Distribution:

	Percentage	Capital Gain	Ordinary Income	Total
Wm. Fleming	30.513%	$893 85	$65,370 39	$66,264 24
Estate A. M. Fleming	30.513%	893 85	65,370 39	66,264 24
Wm. Fleming, Trustee	38.974%	1,141 72	83,497 07	84,638 79
Totals	100.000%	$2,929 42	$214,237 85	$217,167 27

[fol. 289]

Contributions:

Wm. Fleming	$310 01
Estate A. M. Fleming	310 01
Wm. Fleming, Trustee	395 98
Total	$1,016 00

Exhibit B

Fleming Oil Company—Year 1949

Net income per return		$51,205 40
Addition:		
Development expense	$425 00	
Additional deductions:		
Depreciation	$306 97	
Loss on sales	260 45	
Fleming Ranch income overstated	240 00	
Depletion	149 88	
Total additional deductions	$957 30	
Net deduction		532 30
Net income as corrected		$50,673 10
Salary to Wm. Fleming		12,500 00
Amount to be distributed		$38,173 10
Distribution:		

	Rate	Amount	Contributions per Return
Wm. Fleming	30.513%	$11,647 76	$855 13
Estate of A. M. Fleming	30.513%	11,647 76	855 13
Wm. Fleming, Trustee	38.974%	14,877 58	1,092 24
Totals	100%	$38,173 10	$2,802 50

[fol. 290] In the Tax Court of the United States

Docket No. 46713

Wm. Fleming and Bessie M. Fleming (husband and wife), Petitioners,

v.

Commissioner of Internal Revenue, Respondent

Answer—Filed March 19, 1953

Comes now the Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1, 2 & 3

Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4

(a) to (e), inclusive. Denies that respondent's determination is based upon errors as alleged in subparagraphs (a) to (e), inclusive, of paragraph 4 of the petition.

5

(a) to (e), inclusive. Admits the material allegations of fact set forth in subparagraphs (a) to (e), inclusive, of paragraph 5 of the petition.

[fol. 291] (d) Admits that on May 19, 1948, the said partnership, Fleming Oil Company, owned ordinary commercial oil and gas leases, or interests therein, on lands located in Texas. Admits these leaseholds were known as the Denman "C" Lease, the Denman "H" Lease, the Reid "A" and "B" Leases, and the Snyder "C" Lease, all on lands located in Howard County, Texas. Denies the remaining material allegations of fact set forth in subparagraph (d) of paragraph 5 of the petition.

(e) Admits that on May 19, 1948, Fleming Oil Company aforesaid conveyed to Mrs. Marie Hildreth Cline oil-payment interests from the leasehold interest described in the foregoing subparagraph (d). Admits that Fleming Oil Company received from the said Marie Hildreth Cline, as the sole consideration for the properties so conveyed to her, an undivided 50% fee simple interest in approximately 2,994.5 acres of ranch lands in Parker and Tarrant Counties, Texas, this ranch being known as the Cline Ranch. Denies the remaining material allegations of fact set forth in subparagraph (e) of paragraph 5 of the petition.

(f) Admits Fleming Oil Company reported no gain or loss from said transaction in its income tax return for the year 1948. Admits that upon an investigation of said partnership return and the return for 1948 of these petitioners, the respondent made the following determination:

(1) That the market value of said 50% interest in said Cline Ranch on May 19, 1948 was $147,000.

(2) That the net basis in the hands of said partnership for the interests in said oil and gas leases so conveyed to Marie Hildreth Cline was $1,102.79.

[fol. 292] (3) That said $147,000 (the value of a 50% undivided interest in said Cline Ranch) constituted ordi-

nary income of Fleming Oil Company for the calendar year 1948.

(4) That the aforesaid amount of $147,000 represented income from the respective oil and gas leases heretofore referred to, so that said partnership was entitled to deduct an allowance for depletion equal to 27½% of said gross income, or $40,425.

(5) That said partnerships net income from said exchange was $106,575.

Denies the remaining material allegations of fact set forth in subparagraph (f) of paragraph 5 of the petition.

(g) Admits the material allegations of fact set forth in subparagraph (g) of paragraph 5 of the petition.

(h) Admits that on May 19, 1948, petitioner Wm. Fleming was, among other business activities, engaged in the business of acquiring oil and gas properties, developing them and producing oil and gas therefrom. Admits that on that date the said Wm. Fleming owned a 41.667 working interest in an oil and gas lease and leasehold estate conveyed thereby on lands in Eddy County, New Mexico, this oil and gas lease being known as the State (Choate) Lease. The said Wm. Fleming had owned this lease for several years prior to May 19, 1948. Admits that on said date the said Wm. Fleming conveyed to the aforesaid Marie Hil- [fol. 293] dreth Cline a limited overriding royalty interest in said State (Choate) Lease. Admits that as the sole consideration for said transfer, the said Marie Hildreth Cline conveyed to petitioner Wm. Fleming an undivided one-fourth fee simple interest in the aforesaid Cline Ranch. Denies the remaining material allegations of fact set forth in subparagraph (h) of paragraph 5 of the petition.

(i) Admits that petitioners reported no gain or loss from the said transaction in their income tax return for the year 1948. Admits that upon an investigation of said tax return the respondent made the following determinations:

(1) That an undivided one-fourth fee simple interest in said Cline Ranch had a fair market value on May 19, 1948, of $73,500.

(2) That said sum of $73,500 constituted a part of petitioner's gross income for 1948 from the aforesaid State (Choate) Lease.

(3) That petitioners were entitled to an allowance for depletion with respect to said amount of $73,500 equal to 27½% thereof or $20,212.50.

(4) That petitioners derived taxable ordinary income from said exchange of $53,287.50. That accordingly respondent added said amount of $53,287.50 to petitioners' income for the year 1948 as otherwise adjusted, and a substantial portion of the deficiency here involved is based upon this determination.

Denies the remaining material allegations of fact set forth in subparagraph (1) of paragraph 5 of the petition. [fol. 294] (j) and (k) Denies the material allegations of fact set forth in subparagraphs (j) and (k) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation set forth in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the petitioners' appeal be denied and that the Commissioner's determination be approved.

(Signed) Charles W. Davis, JMK, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: James L. Backstrom, District Counsel; Allen T. Akin, Appellate Counsel, J. Marvin Kelley, Special Attorney, Bureau of Internal Revenue, 2nd Floor Mercantile Commerce Building, Dallas 1, Texas.
JMK:jr 3-11-53.

[fol. 295] IN THE TAX COURT OF THE UNITED STATES.

Docket No. 46781

F. HOWARD WALSH AND MARY D. WALSH, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

ANSWER—Filed Mar. 19, 1953

Comes now the Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of

Internal Revenue, and for answer to the petition filed in this proceeding admits and denies as follows:

I—III

Admits the allegations contained in paragraphs I, II, and III, of the petition.

IV

(a)—(d) Denies that the respondent erred in the manner alleged in subparagraphs (a) to (d), inclusive, of paragraph IV, of the petition.

V

(a)—(b) Admits the allegations contained in subparagraphs (a) and (b) of paragraph V, of the petition.

(c) Admits on April 28, 1935 petitioner, Mary D. Walsh, acquired from Pan American Life Insurance Company its [fol. 296] ten year endowment policy No. 274-057 in consideration of an annual premium of $2,248.50, and further payments of a like amount until ten annual premiums had been paid; also admits that the provisions of the policy and the settlement agreement dated November 26, 1943 speak for themselves; that under and in accordance with this settlement provision, petitioner, Mary D. Walsh, received in each of the years 1948 and 1949—$739.92; that the respondent, in determining the deficiencies here involved, treated said sums as interest income derived by petitioners, but denies the remaining allegations contained in subparagraph (c) of paragraph V, of the petition.

(d) Admits on November 2, 1937 petitioner, Mary D. Walsh acquired, for a single premium of $25,000.09 from Southwestern Life Insurance Company its five-year endowment policy No. 347,056 in the face amount of $28,744, to be paid as designated in said policy at its maturity date, to-wit, November 2, 1942; also admits that the agreement with respect to deferment of the amount to be paid and the ultimate payment will speak for itself; that in determining the deficiencies here involved, the respondent added to the petitioners' income for the year 1948, $2,132.18 and, for the year 1949, $2,206.81, but denies the remaining allegations contained in subparagraph (d) of paragraph V, of the petition.

(e) Admits on October 5, 1949 the petitioners owned ordinary commercial oil and gas leases and the lease hold estates conveyed thereby, or interests therein, in and with respect to various lands in Ward County, Texas; that on said date, to-wit, October 5, 1949 petitioners conveyed to [fol. 297] one C. C. Cross limited oil payment interests out of said leases and lease-holds; that petitioners received in exchang therefor, improved real estate located in Tarrant County, Texas but denies the remaining allegations contained in subparagraph (e) of paragraph V, of the petition.

(f) Admits petitioners reported no gain or loss from said transaction in their income tax return for the year 1949; that upon an investigation of said 1949 tax return the respondent made the following determinations:

1. That the market value of said Tarrant County real estate on October 5, 1949 was $65,000.

2. That the limited overriding royalty interests, so transferred to the said C. C. Cross, had no cost or basis in the hands of the petitioners.

3. That said sum of $65,000 constituted a part of petitioners' gross income from the leaseholds, from which the overriding royalties came, as to which petitioners were entitled to an allowance for depletion equal to 27½ per cent of said amount, or $17,875.

4. That petitioners' net income from said exchange was $47,125.,

but denies the remaining allegations contained in subparagraph (f) of paragraph V, of the petition.

(g) Admits the allegations contained in subparagraph (g) of paragraph V, of the petition.

(h)—(i) Denies the allegations contained in subparagraphs (h) and (i) of paragraph V, of the petition.

[fol. 298] (j) Admits the allegations contained in subparagraph (j) of paragraph V, of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed the determination of the Commissioner be sustained.

(Signed) Charles W. Davis, JMK, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: James L. Backstrom, District Counsel, Allen T. Akin, Appellate Counsel, J. Marvin Kelley, Special Attorney, Bureau of Internal Revenue.
JMK/lmm 3/11/53

[fol. 299] IN THE TAX COURT OF THE UNITED STATES

Docket No. 46782.

MARY D. FLEMING WALSH, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

ANSWER—Filed Mar. 19, 1953

Comes now the Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in this proceeding admits, alleges and denies as follows:

1-3

Admits the allegations contained in paragraphs 1, 2, and 3, of the petition.

4

(a)—(e) Denies that the respondent erred in the manner alleged in subparagraphs (a) to (e), inclusive, of paragraph 4, of the petition, and denies the allegations contained in the unlettered subparagraph at the closing of paragraph 4, of the petition.

5

(a)—(b) Admits the allegations contained in subparagraphs (a) and (b) of paragraph 5, of the petition.
[fol. 300] (c) Admits on May 19, 1948 the partnership Fleming Oil Company owned ordinary commercial oil and

gas leases, or interests therein, on lands located in Texas; that these leaseholds were known as the Denman "C" Lease, the Denman "H" Lease, the Reid "A" and "B" Leases, and the Snyder "C" Lease, all on lands located in Howard County, Texas, but denies the remaining allegations contained in subparagraph (c) of paragraph 5, of the petition.

(d) Admits on May 19, 1948 Fleming Oil Company aforesaid, conveyed to Mrs. Marie Hildreth Cline oil payment interests from the leasehold interest described in the foregoing subparagraph (c); that Fleming Oil Company received from the said Marie Hildreth Cline, as the sole consideration for the properties so conveyed to her, an undivided 50% fee simple interest in approximately 2,994.5 acres of ranch lands in Parker and Tarrant Counties, Texas, this ranch being known as the Cline Ranch, but denies the remaining allegations contained in subparagraph (d) of paragraph 5, of the petition.

(e) Admits Fleming Oil Company reported no gain or loss from said transaction in its income tax return for the year 1948; that upon an investigation of said partnership return and the return of Wm. Fleming, Trustee for its fiscal year ended August 31, 1949 the respondent made the following determination:

(1) That the market value of said 50% interest in said Cline Ranch on May 19, 1948 was $147,000.

(2) That the net basis in the hands of said partnership for the interests in said oil and gas leases so conveyed to Marie Hildreth Cline was $1,102.70.

[fol. 304] (3) That said $147,000 (the value of a 50% undivided interest in said Cline Ranch) constituted ordinary income of Fleming Oil Company for the calendar year 1948.

(4) That the aforesaid amount of $147,000 represented income from the respective oil and gas leases heretofore referred to, so that said partnership was entitled to deduct an allowance for depletion equal to 27½% of said gross income, or $40,425.

(5) That said partnership's net income from said exchange was $106,575.

but denies the remaining allegations contained in subparagraph (e) of paragraph 5, of the petition.

(f) Admits the allegations contained in subparagraph (f) of paragraph 5, of the petition.

(g) Admits on May 19, 1940 Wm. Fleming, Trustee was, among other business activities, engaged in the business of acquiring oil and gas properties, developing them, and producing oil and gas therefrom; that on that date, Wm. Fleming, Trustee owned an interest in an ordinary commercial oil and gas lease, and the leasehold estate conveyed thereby, covering lands in Gregg County, Texas known as the J. M. Christian Lease, and also owned a mineral or royalty interest on lands in Cook County, Texas, known as the Ramsey Royalty; that on said date, the said Wm. Fleming, Trustee conveyed to the aforesaid Marie Hildreth Cline limited overriding royalty interest in the above described properties; that as the sole consideration for said transfer, the said Marie Hildreth Cline conveyed to Wm. Fleming [fol. 302] Trustee, an undivided 1/4th fee simple interest in the aforesaid Cline Ranch, but denies the remaining allegations contained in subparagraph (g) of paragraph 5, of the petition.

(h) Admits the trustee of said trust reported no gain or loss from said transaction in the income tax return filed for said trust for the fiscal year ended August 31, 1948; that upon an investigation of said tax return, the respondent made the following determinations:

(1) That an undivided 1/4th fee simple interest in said Cline Ranch had a fair market value on May 19, 1948 of $73,500.

(2) That said sum of $73,500 constituted a part of the gross income of Wm. Fleming, Trustee for its fiscal year ended August 31, 1948 from the aforesaid J. M. Christian and Ramsey Royalty properties.

(3) That Wm. Fleming, Trustee was entitled to an allowance for depletion with respect to said sum of $73,500 equal to 27½% thereof, or $20,212.50.

(4) That the interest in said J. M. Christian and Ramsey Royalty properties so conveyed by Wm. Fleming, Trustee to Marie Hildreth Cline had a net cost or basis in the hands of Wm. Fleming, Trustee totaling $18,119.21.

(5) That Wm. Fleming, Trustee derived taxable ordinary income from said exchange of $53,287.79. Accordingly, respondent added said amount of $53,287.50 to the income of

[fol. 303] Wm. Fleming, Trustee, for the fiscal year ended August 31, 1948 as otherwise adjusted, and a substantial portion of the deficiency determined to be due by Wm. Fleming, Trustee for that fiscal year, as shown in Exhibit A, attached to the petition, is based upon this determination, but denies the remaining allegations contained in subparagraph (h) of paragraph 5, of the petition.

(i) (j) Denies the allegations contained in subparagraph (i) and (j) of paragraph 5, of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

(6) Further answering, respondent alleges:

(a) That on November 30, 1950, the trust created on December 30, 1933 in which Mary D. Fleming (now Mary D. Fleming Walsh) was beneficiary, which trust is known as Wm. Fleming, Trustee, was terminated and all assets of every kind and description belonging to the trust were transferred and conveyed to the beneficiary, Mary D. Fleming Walsh.

(b) That as a result of said conveyance to the petitioner herein, Wm. Fleming, Trustee, was left without assets to satisfy its tax liability.

(c) That the taxes asserted in the notice of deficiency or liability attached to the petition are due and payable.

Wherefore, it is prayed that petitioner's appeal be denied, that the deficiencies as determined by respondent [fol. 304] be, in all respects, approved, and that petitioner be held to be liable at law and in equity as a transferee of the assets of Wm. Fleming, Trustee, in the amount shown in the deficiency notice from which this appeal was taken.

(Signed) Charles W. Davis, JMK, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: James L. Backstrom, District Counsel, Allen T. Akin, Appellate Counsel, J. Marvin Kelley, Special Attorney, Bureau of Internal Revenue.
JMK hmm 3/11/53

In the Tax Court of the United States

Docket No. 46782

Mary D. Fleming Walsh, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

Petitioner's Reply to Respondent's Answer—Filed April 13, 1953

Now comes Mary D. Fleming Walsh, the petitioner in the above styled and numbered cause, by her attorney, [fol. 305] and replies to the affirmative allegations contained in Respondent's answer filed herein on March 15, 1953, which affirmative allegations are contained in Paragraph 6 of said answer, as follows:

1

Petitioner admits the allegations contained in Paragraph 6 (a) of said answer.

2

Petitioner admits the allegations contained in Paragraph 6 (b) of said answer.

3

Petitioner denies the allegations contained in Paragraph 6 (c) of said answer, wherein it is alleged that the taxes asserted in the notice of deficiency or liability attached to the petition are due and payable.

Wherefore, petitioner prays that she be granted the relief prayed for in the petition herein filed.

Harry C. Weeks, Attorney for Petitioner, 525 Forth Worth National Bank Building, Forth Worth, Texas.

Of Counsel: Weeks, Bird, Cannon & Appleman, Fort Worth, Texas.

[fol. 306] IN THE TAX COURT OF THE UNITED STATES

WM. FLEMING and BESSIE M. FLEMING (Husband and Wife) et al.,[1] Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

24 T. C. No. 93

Docket Nos. 46713, 46781, 46782

1 and 2. Exchanges Solely in Kind—Capital Gain—Section 117(j), I.R.C., of 1939.—Petitioners exchanged oil payments for land. Held, that the property was of unlike kind within the meaning of section 112(b)(1), and the gain was taxable as capital gain.

3. Interest—Paid and Accrued.—Under two settlement agreements the proceeds of two endowment policies for petitioner Mary D. Walsh were retained by the insurance company at maturity. In one agreement interest on the retained proceeds was paid to petitioner. Held, that the interest payments were taxable income. Under the other agreement the interest payments were added to the principal sum retained by the insurance company for future distribution. Held, the accrued interest was taxable income to the petitioner in the years before the Court.

[fol. 307] Harry C. Weeks, Esq., for the petitioners.

Daniel A. Taylor, Esq., for the respondent.

OPINION—Filed July 29, 1955

Johnson, Judge: Respondent determined deficiencies in income tax as follows:

Docket No.	Petitioner	Year	Deficiency
46713	Wm. Fleming and Bessie M. Fleming	1948	$94,113.30
46781	F. Howard Walsh and Mary D. Walsh	1948	2,301.31
		1949	38,550.52
46782	Mary D. Fleming Walsh		
		Fiscal year ended 8/31/48	51,976.17
		Fiscal year ended 8/31/49	31,218.55

[1] The following proceedings are consolidated herewith: F. Howard Walsh and Mary D. Walsh (husband and wife), Docket No. 46781; Mary D. Fleming Walsh, Docket No. 46782.

The issues presented are:

(1) Whether an exchange of limited overriding royalties or oil payment interests for the fee simple title to a ranch was an exchange solely in kind under section 112(b)(1), I.R.C. of 1939. In the alternative, if a gain is recognized, is it a capital gain, or ordinary income with depletion allowable?

(2) Would the tax consequences resulting from the exchange above be different where urban real property is substituted for the ranch?

(3) Did petitioners F. Howard Walsh and Mary D. Walsh receive taxable income in 1948 and 1949 because of [fol. 308] certain transactions involving endowment life insurance policies?

Petitioner Mary D. Fleming Walsh has stipulated that she is liable as a transferee for whatever deficiencies in income tax are finally determined against Wm. Fleming, Trustee, for the fiscal years ended August 31, 1948, and August 31, 1949.

All of the facts have been stipulated and are so found and we summarize therefrom as follows:

Wm. Fleming and Bessie M. Fleming were husband and wife, as were F. Howard Walsh and Mary D. Walsh. Mary D. Fleming Walsh (Mary D. Walsh) was also the daughter of Wm. Fleming. All petitioners were residents of Fort Worth, Texas, and their income tax returns were filed on a cash basis with the collector of internal revenue for the second collection district of Texas.

Issue 1

For all the years before us Wm. Fleming was the sole trustee and Mary D. Walsh was the sole beneficiary of the private trust known as "Wm. Fleming, Trustee." This trust was created in 1931 and continued in existence until 1950. The trust kept its books on a cash basis for a fiscal period ending August 31 of each year, and its income tax returns were filed with the collector of internal revenue for the second collection district of Texas.

For the years before us the Fleming Oil Company was a partnership composed of Wm. Fleming and Wm. Flem-

ing, Trustee. The partnership produced oil and gas; and [fol. 309] made investments. Wm. Fleming held a 61.026 per cent interest in the business, and Wm. Fleming, Trustee, a 38.974 per cent interest. Partnership books were kept on a cash basis, and tax returns for the partnership were filed with the collector of internal revenue for the second collection district of Texas.

On May 19, 1948, Marie Hildreth Cline (joined by her husband) conveyed an undivided fee simple title to 2,994.5 acres of ranch land to the Fleming Oil Company (50 per cent), Wm. Fleming, Trustee (25 per cent), and Wm. Fleming (25 per cent). As consideration for this conveyance the grantees of the land conveyed and assigned to Marie Hildreth Cline certain limited overriding royalties or oil payment interest. These limited overriding royalties or oil payment interests came from oil and gas leases, or oil and gas mineral leases, which the transferors had owned for more than six months prior to May 19, 1948, for productive use in their respective trades and businesses and for sale. The ranch was acquired for investment and not for sale.

Pertinent parts of the various oil payments to Marie Hildreth Cline are presented below:

In the first, the Fleming Oil Company, as owner of one-half of seven-eighths of certain oil and gas lease-hold estates:

. . . . does hereby sell, assign, and convey unto the said Mrs. Marie Hildreth Cline, as a part of her separate property and estate, her heirs and assigns, the following described real property, to-wit:

[fol. 310] An overriding royalty and mineral interest carved hereby out of the interest owned by Fleming Oil Company in each and all of the oil and gas leases described above, amounting to an undivided 49/128ths interest in and to all the oil in, under, and that may be produced, saved and marketed from the above described tracts of land under the terms of the oil and gas leases covering same until the grantee named above shall have received therefrom oil of the net value of One Hundred Forty-seven

Thousand Dollars ($147,000.00) plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $147,000.00 which may be unsatisfied from time to time.

This grant was made subject to certain conditions, limitations, and agreements, such as:

(1) No interest in the gas or casinghead gas in, under, or produced and saved from said tracts, and no interest in the personal property now or hereafter placed thereon is assigned or conveyed to grantee, this conveyance affecting the oil only.

. . . . . .

(5) When and if the grantee herein, her heirs and assigns, have received from the fractional interest hereby assigned, oil of the net value of $147,000.00, plus an amount equal to five per cent (5%) interest as above provided, then the interest hereby conveyed to said grantee shall cease and terminate, and said interest shall revert to, and shall thereafter be owned by grantor, its successors, heirs or assigns; and grantee, her heirs and assigns, shall have [fol. 311] no further interest in said oil and gas leasehold estates covering said land, or in the oil thereunder; and grantee, her heirs or assigns, shall, upon request, execute such instruments as may be necessary or proper to evidence this of record.

(6) The execution of this conveyance shall not impose upon grantor any obligation with respect to developing or operating the property covered hereby, nor shall it be implied herefrom that grantor is in anywise obligated to see that grantee receives oil aggregating the net value of $147,000.00, plus an amount equal to five per cent (5%) interest as above provided, or any lesser sum; but grantor does covenant and agree that grantee shall have the same but no greater right to require grantor to develop and operate said property in accordance with the terms of the original leases upon said property as the original lessors therein, their heirs or assigns, might have or exercise.

Marie Hildreth Cline's share of oil produced from the property described in the Fleming Oil Company assign-

ment, from the effective date of the assignment to the close of 1952, amounted to:

Year	Amount
1948	$15,801.16
1949	22,835.94
1950	31,172.41
1951	31,350.19
1952	30,558.54

In the next oil payment, Wm. Fleming, as owner of an undivided interest in certain oil and gas leases:

[fol. 312] * * * does hereby sell, assigns, and convey unto the said Mrs. Marie Hildreth Cline, as a part of her separate property and estate, and to her heirs and assigns, the following described real property, to-wit:

An overriding royalty and mineral interest carved hereby out of the interest owned by Wm. Fleming in each and all of the oil and gas leases described above, amounting to a .166668 interest in and to all the oil in, under, and that may be produced, saved and marketed from the above described tracts of land under the terms of the oil and gas leases covering same, until the grantee named above shall have received therefrom oil of the net value of Seventy-three Thousand Five Hundred Dollars ($73,500.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $73,500.00 which may be unsatisfied from time to time.

This grant was also made subject to certain conditions, limitations, and agreements. These were similar to those in the Fleming Oil Company assignment. Marie Hildreth Cline's share of oil produced from this property, from the effective date of the assignment to the close of 1952, amounted to:

Year	Amount
1948	$ 5,423.49
1949	9,412.84
1950	7,916.69
1951	4,854.74
1952	6,420.78

The oil payment from Wm. Fleming, Trustee, conveyed to Marie Hildreth Cline the following described interest:

[fol. 313] An overriding royalty and mineral interest carved hereby out of the interest owned by Wm. Fleming, Trustee, in each and all of the oil and gas leases described above, amounting to an undivided 6-100ths interest in and to 7/8ths of all the oil in, under, and that may be produced, saved and marketed from the above described tract of land under the terms of the oil and gas leases covering same, until the grantee named above shall have received therefrom oil of the net value of Forty-nine Thousand Dollars ($49,000.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $49,000.00 which may be unsatisfied from time to time.

Like the other grants, this was also subject to certain conditions, limitations, and agreements. Marie Hildreth Cline's share of the oil produced from this property, from the effective date of the assignment to the close of 1952, amounted to:

Year	Amount
1948	$ 4,436.99
1949	7,365.73
1950	7,423.68
1951	7,793.11
1952	7,730.24

Wm. Fleming, Trustee, also conveyed by a mineral deed certain royalty interests to Marie Hildreth Cline as part consideration for the ranch. In this deed the trust did "grant, sell, and convey unto the said grantee, as a part of her separate property and estate, un [sic] undivided 32.3535/400ths royalty interest in and to all of the oil in, [fol. 314] under, and that may be produced from" certain real property. The deed further provided:

Said land being now under an oil and gas lease, it is understood and agreed that this sale is made subject to the terms of said lease, but covers and includes 32.3535/400ths of the 1/8th royalty on oil due and to be paid under the terms of said lease, insofar as it covers the above described land, until the grantee named above shall have received oil of the net value of Twenty-four Thousand Five Hundred Dollars ($24,500.00), plus an amount equal to five

per cent (5%) interest per annum from May 19, 1948, on the portions of said $24,500.00, which may be unsatisfied from time to time.

Like the other grants, this was also made subject to certain conditions, limitation, and agreements. Marie Hildreth Cline's share of the oil produced from this property, from the effective date of the conveyance to the close of 1952, amounted to:

Year	Amount
1948	$ 2,306.57
1949	3,393.20
1950	3,913.38
1951	3,985.71
1952	3,248.27

On the tax returns of Wm. and Bessie M. Fleming, and the Fleming Oil Company (a partnership), for the calendar year 1948, and Wm. Fleming, Trustee, for the fiscal year ended August 31, 1948, the exchange of the ranch for the oil payments was treated as an exchange of property of like kind under section 112(b)(1). However, respondent [fol. 315] determined that they received a gain from this exchange and adjusted their 1948 income accordingly. Respondent explained this adjustment to Wm. and Bessie M. Flemings 1948 net income as follows:

(d) Your gain on the exchange of an oil payment, face amount $73,500.00, plus 5% interest payable out of 40% of 41.667 W.I. in State (Choate) Lease, Eddy County, New Mexico, for a 1/4 undivided interest in 2,994 1/2 acres in Parker and Tarrant Counties, Texas, has been computed as follows:

Consideration, fair market value of land received, held to be face value of oil payments—

1/4 of $294,000.00	$ 73,500.00
Cost basis of oil payment assigned, depletion, 27 1/2% of $73,500.00	20,212.50
Income increased	$ 53,287.50

Respondent's determination, tabulated for each of the assignors, is as follows:

	Fleming Oil Co.	Wm. Fleming	Wm. Fleming Trustee
Fair market value of interest in Cline ranch received	$147,000 00	$73,500 00	$73,500 00
Net cost or basis of property transferred	1,102 70	None	18,119 21
Percentage depletion allowable to	40,425 00	20,212 50	20,212 50
Net income from exchange received	106,575 00	53,287 50	53,287 50

[fol. 316] Since the Fleming Oil Company was a partnership, in the final adjustment respondent distributed the partnership income to the partners; the beneficiary's income from the trust was also adjusted.

The exchanges by Fleming Oil Company, Wm. Fleming and Wm. Fleming, Trustee, of oil payments out of oil and gas leases situated in the Counties of Howard, Gregg and Cooke in the State of Texas and Eddy County, New Mexico, for fee simple title to 2,994½ acres of ranch lands situated in Parker and Tarrant Counties, Texas, were not exchanges of property for property of a like kind and the gain derived therefrom was capital gain. In this first issue the question is whether the exchange here of limited overriding royalties or oil payment interests for the fee simple title to ranch land was an exchange of "property of a like kind" within the meaning of section 112(b)(1) I.R.C. of 1939.[2] If so, petitioners' gain therefrom should not have been recognized in computing their taxable income, since the parties admit the existence of the other requirements of the section. Petitioners contend the properties were of like kind, while respondent determined that they were not.

* * * * * * *

(b) Exchanges Solely in Kind.—

(1) Property Held for Productive Use or Investment.—No gain or less shall be recognized if property held for productive use in trade or business or for investment * * * is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

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[2] Sec. 112. Recognition of Gain or Loss.

[fol. 317] Treasury regulations, in defining the meaning of "like kind" as here used, state that same "have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under such section, be exchanged for property of a different kind or class." The meaning of the words is there further particularized by citing examples of nontaxable exchanges, which include exchange of "city real estate for a farm or ranch, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unimproved real estate." See Regulations 111, Section 29.112(b)(1)—1.

Similar interpretations have appeared in all of the regulations, beginning with Regulation 62, issued under the Revenue Act of 1921. These have all likewise interpreted the term "like kind", and the statute in question has been repeatedly reenacted by Congress without change since the Revenue Act of 1924. "Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law." Helvering v. R. J. Reynolds Tobacco Co., 306 U.S. 110. This regulation has also been uniformly followed and approved by the Courts.

Applying the above regulation to the facts here, we do not think the properties in question have the same "nature or character," nor are they of the same "kind or class," hence they are not "of a like kind" within the meaning of the statute.

In comparing properties to determine their likeness within the meaning of section 112(b)(1), we must con- [fol. 318] sider not alone the nature and character of the physical properties, but also the nature and character of the title conveyed or the rights of the parties therein. The accepted legal definition of "property" so contemplates and requires. We quote:

> In law it is not the physical, material object alone which constitutes "property." The term means something more than the mere thing which a person owns. * * * [73 C.J.S. 138]

The word "property" means not only the thing possessed, that is the physical corporeal thing, but also rights in the physical, corporeal thing which are created and

sanctioned by law. [73 C.J.S. 140; Texas Co. v. Hauptman, 91 F. 2d 449 and other cases there cited.]

The rights created in the property determine the character of the property owned.

The above cited regulation gives recognition to this legal definition of property. In effect it provides that even if both properties exchanged are realty, if there be substantial difference in the rights created in and to the respective properties, then the properties are not of a like kind. Illustrative of this, it provides that a leasehold interest in land cannot be exchanged for a fee title in land without tax consequences, unless the lease has "thirty years or more [fol. 319] to run."[3] The implication is clear that the rights vested in the respective grantees in and to the properties exchanged must be of the same general character or of substantial equality. If not, then the properties exchanged are not of like kind within the meaning of the Code. It was so held in Midfield Oil Co., 39 B.T.A., 1154, relied upon by respondent, and which sustains his contention here. There it was held that an oil payment limited in amount is different within the meaning of section 112(b)(1) from an overriding royalty which continues as long as production lasts.

The reason there given for holding the properties unlike was because of the "differences in the rights created by the Holmans oil payment and the Dawson overriding royalty," which were held to be "differences of substance and not of mere form." The rights under the Holmans oil payments were to continue only until a specified sum of money was realized therefrom, while the Dawson royalty rights "continued for so long as oil or gas might be produced from the property."

In the instant case the rights created in the overriding royalties or oil payments were almost identical with those created in the Holmans oil payments, the only difference being the amount in dollars and cents to be paid, but in

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[3] This provision of the regulation was discussed and approved in Century Electric Co., 15 T.C. 581, affd. 192 F. 2d 155, certiorari denied, 342 U.S. 954. In Standard Envelope Manufacturing Co., 15 T.C. 41, it was held a lease for 25 years "was not equivalent to a fee."

both, upon completion of payment of the sum specified, the oil interests assigned were to revert to the grantor. Midfield Oil Co., supra, was approved and followed in Kay Kimball, 41 B.T.A. 940.

[fol. 320] Petitioners cite Commissioner v. Crichton, 122 F. 2d 181, affirming Kate J. Crichton, 42 B.T.A. 490, where it was held that an exchange of an undivided interest in oil, gas and other minerals for an undivided fee in a parcel of improved realty was an exchange within the meaning of section 112(b)(1).

That case does not sustain petitioners' contention here. There the mineral interest conveyed was not for a limited period but was an outright and absolute conveyance of the "oil, gas and other minerals in, on and under and that may be produced from" the land therein described. There was no limitation or restriction of any kind. The difference in this respect from the Midfield Oil Co., supra, is pointed out in the Board of Tax Appeals' opinion in the Crichton case, supra. (See 42 B.T.A. at p. 492)

Petitioners rely on Fleming v. Campbell (C.A. 5) 205 F. 2d 549, reversing a U.S.D.C. N.D. Texas case (Sept. 29, 1952). The Appellate Court in its reversal held that an exchange of a limited overriding royalty or oil payment solely for a determinable fee in an oil and gas lease was an exchange of property of like kind within the meaning of section 112(b)(1). Apparently Government counsel there rested their case solely on the ground

" " " that the mineral interest in the Ector County lands was an interest in fee and that in the Gregg County lands, for which it was exchanged, was a leasehold of a fee which does not have thirty or more years to run, and hence that therefore under the regulation the interests exchanged were not of like kind.

[fol. 321] The Court decided the case on the issue as presented and held that both interests exchanged were interests in minerals in place and hence both were interests in land; further, that neither interest was a "leasehold of a fee" in the sense that term is used in the regulation, and therefore the thirty year provision of the regulation did not apply. The issue there is not present in the instant case and the facts here are wholly different.

Here the exchange was not "mineral interests for mineral interests", but an exchange of a fee simple title, an absolute

estate in ranch land for a limited mineral interest which expired when a definite sum of money was realized therefrom.

Notwithstanding the comprehensive terms of conveyance contained in the assignment of the mineral interest, the ceiling limitation therein, whereby the maximumu amount the grantee could ever receive therefrom was a fixed sum of money with interest, stamps the extent of grantee's rights therein more in the nature of a mortgagee than that of owner. The grantee's interest was primarily monetary and of a temporary nature. The grantors at all times owned a residuary title in the mineral property. In any event a temporary title to the oil properties, continuing only until a sum of money is realized therefrom, is not equivalent to an absolute and unconditional title in the ranch land. The rights created were wholly different. The properties here exchanged were not of like kind within the meaning of section 112(b)(1).

Now that we have determined that there was a taxable gain from the exchange, we must ascertain whether it was [fol. 322] ordinary income, as determined by respondent, or capital gain, as contended by petitioners. This question must be decided in favor of the petitioners upon authority of John David Hawn, 23 T. C. 516, Lester A. Nordan, 22 T.C. 1132, and Caldwell v. Campbell, Jr., 218 F. 2d 567, from which this case is not distinguishable in principle. See Walter A. Henshaw, 23 T.C. 176. These cases hold that an oil payment is a capital asset and the gain derived from the sale or exchange of an oil payment may be given capital gains treatment. Similarly, the petitioners' gain from the exchange of the oil payments is entitled to capital gains treatment. Petitioners are sustained on this question.

In arriving at our conclusion that petitioners' gain was a capital gain, we have considered, but cannot sustain, respondent's contention that petitioners' transaction was the mere assignment of future income in exchange for a ranch.

Issue II

On October 5, 1949, C. C. Cross conveyed to F. Howard Walsh the fee simple title to certain urban real estate in Fort Worth, Texas. As the sole consideration for this land, F. Howard Walsh conveyed to Cross certain limited

overriding royalties or oil payment interest." Walsh's conveyance to Cross was in part as follows:

" " " F. Howard Walsh, does hereby, subject to the conditions and limitations hereinafter set out, bargain, sell, assign and convey unto C. C. Cross, of Tarrant County, Texas, his heirs and assigns, the following described over-[fol. 323] riding royalty and mineral interests carved out of the interests owned by the undersigned grantor in and to the oil and gas leases and leasehold estates, insofar as they cover the tracts of land and leases described above,—such interests herein conveyed being the following fractional parts of the oil, in, under, or upon, or that may be produced from such tracts of land under the terms of said leases, to-wit:

(a) 1/4 of 7/8 of such oil, insofar as all of the tracts and leases in Ward County above described are concerned, save and except Walsh's "Killough" Lease; and

(b) 1/4 of 7/16 of such oil, insofar as such Killough Lease is concerned.

This grant is made subject to the following conditions and limitations, to-wit:

. . . . . .

(c) When and if Cross, or his heirs and assigns, shall have received, under the terms of said conveyance and assignment, oil of the net value of Sixty-Five Thousand and No/100 Dollars ($65,000.00), plus interest at the rate of seven (7) per cent per annum on the balances unpaid from time to time (exclusive of gross production taxes, which may be deducted from Cross's part of the oil),—then Cross shall have no further interest in said oil and gas leases or leasehold estate, and the oil then remaining in, under or upon said tracts of land, or thereafter produced therefrom; and the interests hereby conveyed shall automatically revert to Walsh his heirs and assigns.

[fol. 324] Corss's share of the oil produced from the property named in the conveyance, from the effective date of the conveyance to the close of 1952, amounted to:

Year	Amount
1949	$ 3,909.61
1950	22,391.12
1951	22,673.03
1952	21,793.90

On their 1949 income tax return F. Howard Walsh and his wife treated this transaction as an exchange of property of like kind under section 112(b)(1). Respondent determined that the transaction produced ordinary depletable income for them. Respondent also determined that the real estate acquired by Walsh had a market value of $65,000, that the limited overriding royalties or oil payment interest had no basis in Walsh's hands, and that the allowance for depletion was $17,875, with a net income of $47,125 taxable to Walsh and his wife in 1949.

The exchange by F. Howard Walsh of an oil payment out of oil and gas leases situated in Ward County, Texas, for fee simple title to revenue producing real estate situated in Fort Worth, Tarrant County, Texas, was not an exchange of property for property of a like kind and the gain derived therefrom is taxable income.

In this issue petitioners F. Howard Walsh and Mary D. Walsh conveyed an oil payment to C. C. Cross for a piece of urban real property. There is no real difference between this exchange and that we discussed in the first issue. [fol. 325] Therefore, for the reasons stated in the first issue, petitioners' gain in this issue is taxed like the gain considered in the first issue.

[fol. 326] Decision will be entered under Rule 50.

IN THE TAX COURT OF THE UNITED STATES

Docket No. 46713

WM. FLEMING and BESSIE M. FLEMING, Husband and Wife, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION—Entered September 28, 1955

Pursuant to Opinion of the Tax Court filed July 29, 1955, respondent filed a computation on September 27, 1955, in which petitioners concurred. Now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1948 in the amount of $43,813.48.

(Signed) Luther A. Johnson, Judge.

[fol. 327] In the Tax Court of the United States

Docket No. 46781

F. Howard Walsh and Mary D. Walsh, Husband and Wife, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Decision—Entered September 28, 1955

Pursuant to Opinion of the Tax Court filed July 29, 1955, respondent filed a computation on September 27, 1955, in which petitioners concurred. Now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1948 and 1949 in the respective amounts of $2,217.94 and $18,896.79.

(Signed) Luther A. Johnson, Judge.

In the Tax Court of the United States

Docket No. 46782

Mary D. Fleming Walsh, Petitioner

v.

Commissioner of Internal Revenue, Respondent

Decision—Entered September 28, 1955

Pursuant to Opinion of the Tax Court filed July 29, 1955, respondent filed a computation on September 27, 1955, in [fol. 328] which petitioner concurred. Now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the fiscal year ended August 31, 1948 and the fiscal year ended August 31, 1949, in the respective amounts of $23,889.26 and $16,145.41.

(Signed) Luther A. Johnson, Judge.

In the Tax Court of the United States

Docket No. 46713

Wm. Fleming and Bessie M. Fleming, husband and wife, Petitioners,

v.

Commissioner of Internal Revenue, Respondent

Docket No. 46781

F. Howard Walsh and Mary D. Walsh, husband and wife, Petitioners,

v.

Commissioner of Internal Revenue, Respondent

Docket No. 46782

Mary D. Fleming Walsh, Petitioner

v.

Commissioner of Internal Revenue, Respondent

Stipulation for Consolidation on Petition for Review—Filed Dec. 1, 1955

The petitioners above named and the Commissioner of Internal Revenue, each acting by and through their respec- [fol. 329] tive attorneys of record, hereby agree and stipulate as follows:

The above-styled and numbered causes shall be, and they are hereby, consolidated for the purpose of review by the United States Court of Appeals for the Fifth Circuit of

the decisions heretofore entered by The Tax Court of The United States in said causes; said review being taken at the instance of the petitioners. In all of the proceedings which the petitioners may take to obtain a review of said decisions, they may proceed as if there was only one cause and join said causes in one Petition for Review, and present to The United States Court of Appeals for the Fifth Circuit only one Petition for Review and only one record, which shall embrace all of the pertinent proceedings had in said consolidated causes.

In the event the Respondent should determine to file a Petition for Review of said decisions, he, likewise, may proceed as if there were only one cause and join said causes in one Cross Petition for Review and present to The United States Court of Appeals only one Cross Petition for Review and only one record, which shall embrace all of the pertinent proceedings had in said consolidated causes.

This agreement and stipulation are entered into because said proceedings were consolidated for hearing and decision before The Tax Court of The United States, and because in several respects said causes involved the same transactions and most of the evidence and proceedings in one of said causes are equally applicable to and pertinent to the other, and because they were disposed of by The Tax Court of The United States in one opinion.

[fol. 330] Executed upon behalf of the above named parties by their respective attorneys of record this 1st day of November, 1955.

Harry C. Weeks, Attorney for Petitioners, John Potts Barnes, Jr., Attorney for Respondent. (Signed) John Potts Barnes, CAR.

IN THE TAX COURT OF THE UNITED STATES

Docket No. 46713

WM. FLEMING and BESSIE M. FLEMING, Husband and Wife, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 46781

F. HOWARD WALSH and MARY D. WALSH, Husband and Wife, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 46782

MARY D. FLEMING WALSH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION — Filed Jan. 13, 1954

The parties to the above styled and numbered causes, and each of them, acting herein by and through their respective attorneys of record, hereby agree and stipulate as follows:

[fol. 331] 1

These proceedings shall be consolidated for hearing and decision, and shall be removed from the Dallas, Texas Calendar of The Tax Court of The United States, and shall be submitted to The Tax Court of The United States at Washington, D. C. under and in accordance with Rule 30 of the Rules of Practice Before The Tax Court of The United States.

2

Upon submission of these causes, in accordance with the foregoing paragraph, the facts herein set forth shall be accepted as true and, with the admissions of fact made in the pleadings filed in these causes, shall constitute the evidence upon which these causes are submitted.

3

At all times pertinent to these proceedings, Wm. Fleming and Bessie M. Fleming, the Petitioners in Cause No. 46713, were husband and wife residing together in Fort Worth, Texas. Likewise, F. Howard Walsh and Mary D. Walsh, the Petitioners in said Cause No. 46781, were at all such pertinent times husband and wife residing together in Fort Worth, Texas. Mary D. Fleming Walsh, the Petitioner in said Cause No. 46782, is the same person as Mary D. Walsh, one of the Petitioners in Cause No. 46781, and is the daughter of Wm. Fleming, one of the Petitioners in Docket No. 46713.

4

Throughout each and all of the years involved in each and all of these proceedings, there existed a private trust [fol. 332] known as "Wm. Fleming, Trustee", of which the aforesaid Wm. Fleming was the sole Trustee and Mary D. Fleming Walsh was the sole beneficiary. This Trust had been created in 1931, and it continued in existence until on or about November 30, 1950, when it was terminated in accordance with its terms, and all assets of every kind and description belonging to the Trust were transferred and conveyed to the said beneficiary, Mary D. Fleming Walsh. Said Trust kept its books and records upon the cash receipts and disbursement basis and for fiscal year periods ending on August 31 of each year. Throughout its existence said Trust filed income tax returns with the Collector of Internal Revenue for the Second Collection District of Texas at Dallas, Texas. This Trust is the same trust which was the Appellant in Wm. Fleming, Trustee, v. Commissioner of Internal Revenue, 121 F. 2d 7, affirming 43 B T A 229, and the allocation for deductions of depreciation and depletion between said Trust and its beneficiary

are to be made in accordance with the rules laid down in said opinions.

5

During all of the times involved in these proceedings, and each of them, Wm. Fleming and Mr. Fleming, Trustee were engaged in business as partners under the name and style of "Fleming Oil Company"; the partnership business being primarily that of producing oil and gas, and, secondarily, of making investments. During such times, the interest of the said Wm. Fleming in said partnership was 61.026 per cent, and of Wm. Fleming, Trustee 38.974 per cent. Said partnership kept its books and records and made its income tax returns upon the cash receipt and dis- [fol. 333] bursement basis and for calendar year periods. The tax returns of said partnership were filed with the Collector of Internal Revenue for the Second Collection District of Texas at Dallas, Texas.

6

Wm. Fleming and wife, Bessie M. Fleming, kept their books and records and made their income tax returns upon the cash receipt and disbursement basis and for calendar year periods. They filed a joint return for the year 1948. Petitioners, F. Howard Walsh and Mary D. Walsh, kept their books and records and made their income tax returns upon the cash receipt and disbursement basis and for calendar year periods. They filed joint income tax returns for the years 1948 and 1949. All the tax returns referred to in this paragraph were filed in the office of the Collector of Internal Revenue for the Second Collection District of Texas at Dallas, Texas.

7

On May 19, 1948, in accordance with a pre-existing agreement so to do, an exchange was consummated between Fleming Oil Company, Wm. Fleming, Trustee and Wm. Fleming, on the one hand, and Marie Hildreth Cline on the other, by which Fleming Oil Company, Wm. Fleming, Trustee and Wm. Fleming were conveyed by the said Marie Hildreth Cline (joined by her husband), in the proportion of an undivided fifty per cent (50%) to Fleming Oil Company, and an undivided twenty five per cent (25%) to Wm.

Fleming, Trustee, and a like undivided twenty five per cent (25%) to Wm. Fleming, the fee simple title to some [fol. 334] 2,994.5 acres of land situated in Parker and Tarrant Counties, Texas, then used and suitable for ranching purposes. As the sole consideration for said conveyance, Fleming Oil Company, Wm. Fleming, Trustee and Wm. Fleming assigned and conveyed to the said Marie Hildreth Cline the limited overriding royalty or oil payment interests herein more fully described. These limited overriding royalty or oil payment interests came from oil and gas leases, or oil and gas mineral interests, which the respective transferors had held and owned for considerably more than six (6) months prior to the date of said transaction—May 19, 1948,—for productive use in their respective trades and businesses and not for sale. The said ranch so acquired in said exchange by Fleming Oil Company, Wm. Fleming, Trustee and Wm. Fleming, was acquired by them, and each of them, for investment, and has been held for investment, and not for sale, since said acquisition.

8

The limited overriding loyalty or oil payment interests conveyed by Fleming Oil Company to Marie Hildreth Cline, as aforesaid, were conveyed by an instrument, a copy of which is attached hereto, marked Exhibit A for identification, and hereof made a part for all purposes. The O. L. Denman "C", the O. L. Denman "H" Leases, the C. D. Read "A" and "B" Leases, and the D. H. Snyder Lease referred to in said Exhibit A were ordinary commercial oil and gas leases on lands in Texas, and each of them was then producing oil and gas. The fair market value and selling price of the share of the oil produced from said properties, from and after the effective date of the [fol. 335] assignment to Marie Hildreth Cline to the close of the year 1952, applicable to the interest so conveyed to her, were:

1948	$15,801.16
1949	22,835.94
1950	31,172.41
1951	31,350.19
1952	30,559.54

9

The limited overriding royalty *royalty* or oil payment interest conveyed by Wm. Fleming to Marie Hildreth Cline, as aforesaid, was conveyed by an instrument, a copy of which is attached thereto, marked Exhibit B. for identification, and hereof made a part for all purposes. The L. H. Choate Lease, referred to in said Exhibit B, was an ordinary commercial oil and gas lease on lands in Eddy County, New Mexico, and was then producing oil and gas. The fair market value and selling price of the share of the oil produced from said property, from and after the effective date of the assignment to Marie Hildreth Cline to the close of the year 1952, applicable to the interest so conveyed to her, were:

1948	$5,423.49
1949	9,412.84
1950	7,916.69
1951	4,854.74
1952	6,420.78

[fol. 336] 10

One of the limited overriding royalty or oil payment interests conveyed by Wm. Fleming, Trustee to Marie Hildreth Cline, as aforesaid, was conveyed by an instrument, a copy of which is attached hereto, marked Exhibit C for identification, and hereof made a part for all purposes. The J. M. Christian lease, referred to in said Exhibit C, was an ordinary commercial oil and gas lease on lands in Gregg County, Texas, which was then producing oil and gas. The fair market value and selling price of the share of the oil produced from said property, from and after the effective date of the assignment to Marie Hildreth Cline to the close of the year 1952, applicable to the interest so conveyed to her, were:

1948	$4,436.99
1949	7,365.73
1950	7,423.68
1951	7,793.11
1952	7,730.24

The other limited overriding royalty or oil payment interest conveyed by Wm. Fleming, Trustee to Marie Hildreth Cline was conveyed by an instrument, a copy of which is attached hereto, marked Exhibit D for identification, and hereof made a part for all purposes. The interest so conveyed came from a mineral interest in Cooke County, Texas, then owned in fee by Wm. Fleming, Trustee, and which lands were then producing oil and gas. The fair market value and selling price of the share of the oil produced from said property, from and after the effective date of the assignment to Marie Hildreth Cline to the close of the year [fol. 337] 1952, applicable to the interest so conveyed to her, were:

1948	$2,306.57
1949	3,393.20
1950	3,913.38
1951	3,985.71
1952	3,248.27

11

In their respective tax returns for the appropriate periods, the calendar year 1948 for Wm. Fleming and wife, Bessie M. Fleming, and for the partnership Fleming Oil Company, and as to Wm. Fleming, Trustee, for the fiscal year ended August 31, 1948 the exchange between the said Marie Hildreth Cline on the one hand, and Wm. Fleming, Wm. Fleming Trustee, and Fleming Oil Company on the other, was treated as an exchange of properties of like kind under Section 112(b)(1) of the Internal Revenue Code. But in making the final determinations of the income of Wm. Fleming and wife, Bessie M. Fleming, Fleming Oil Company and Wm. Fleming Trustee, the respondent held and determined that each of said exchanges produced ordinary income from the respective properties out of which the various interests conveyed by them came, and that the respective assignors were entitled to allowances for depletion computed under Section 114(b)(3) of the Internal Revenue Code, with respect to such gross income, and further made the related determinations set forth in the following tabulation:

[fol. 338]

	Fleming Oil Co.	Wm. Fleming	Wm. Fleming Trustee
Fair market value of interest in Cline Ranch received	$147,000.00	$73,500.00	$73,500.00
Net cost or basis of property transferred by	1,102.70	None	18,119.21
Percentage Depletion allowable to	40,425.00	20,212.50	20,212.50
Net income from exchange received by	106,575.00	53,287.50	53,287.50

Accordingly, in determining the deficiencies and transferee liabilities here involved, the respondent, on account of said Cline exchange, added $106,575 to the income of said Fleming Oil Company for 1948 as otherwise determined by him; and on this account increased the net income of Wm. Fleming and wife, Bessie M. Fleming, as otherwise determined by him, by 61.026 per cent thereof as their distributive share of said partnership earnings for 1948; and further increased their said income for said year by $53,287.50, on account of that portion of the said exchange directly between said Wm. Fleming and said Marie Hildreth Cline. Further, in determining the income of Wm. Fleming, Trustee for its fiscal year ended August 31, 1948, respondent added to the income, as otherwise determined by him for that period, $53,287.50, on account of that portion of said exchange directly between Wm. Fleming, Trustee, and Marie Hildreth Cline; and, in his determination of the income of Wm. Fleming, Trustee, for its fiscal year ended August 31, 1949, added 38.974 per cent of $106,575 to said Trust's distributive share of the profits of the partnership, Fleming Oil Company for 1948, as otherwise determined [fol. 339] by him. Further, respondent determined that said Trust distributed to its beneficiary, Mary D. Walsh, $10,000 during its fiscal year ended August 31, 1948, and $27,000 during its fiscal year ended August 31, 1949.

12

On October 5, 1949, in accordance with an existing agreement so to do, one C. C. Cross conveyed to petitioner F. Howard Walsh, the fee simple title to revenue-producing business real estate located in Fort Worth, Tarrant County, Texas, and, as the sole consideration for this conveyance, F. Howard Walsh conveyed to said C. C. Cross limited overriding royalty or oil-payment interests out of various ordinary commercial oil and gas leases on lands in Texas

which were then producing oil and gas, and which the said F. Howard Walsh had then owned and held for much more than six (6) months for productive use in his business of producing oil, and not for sale. The real estate so acquired by the said Walsh in Fort Worth, Texas, was acquired by him for investment and not for sale. The limited overiding royalty or oil-payment interests conveyed by F. Howard Walsh to the said C. C. Cross were conveyed by an instrument a copy of which is attached hereto, marked Exhibit E and made a part hereof for all purposes. This transaction was treated by the said Walsh and wife in their said 1949 income tax return as exchange of properties of like kind under Section 112(b)(1) of the Internal Revenue Code, but respondent, in determining the deficiency asserted against them for 1949, determined that said transaction produced ordinary depletable income taxable to them for 1949, just as he had done with respect [fol. 340] to the Fleming, et al.—Cline exchange heretofore dealt with, and for the same reasons. As to the Walsh—Cross Exchange, respondent determined that the Fort Worth real estate so received by Walsh then had a market value of $65,000, that the limited overriding royalties or oil payments transferred to Cross by Walsh had no net cost or basis in Walsh's hands and Walsh was entitled to an allowance for depletion with respect to said $65,000 of $17,875, leaving $47,125 net income from the transaction taxable to Walsh and wife for 1949. The fair market value and selling price of the share of the oil produced from said property and applicable to the interests so conveyed by Exhibit E to Cross from and after the effective date of said conveyance to the close of the year 1952 were:

1949	$ 3,909.61
1950	22,391.12
1951	22,673.03
1952	21,793.90

[fol. 341] 15

Mary D. Fleming Walsh, the petitioner in docket No. 46782, stipulates and admits that she is liable as a transferee for whatever deficiency in income tax may be finally found to be due by Wm. Fleming Trustee for the taxable

periods of Wm. Fleming Trustee involved in said docket No. 46782.

In Witness Whereof, this stipulation has been executed in several counterparts upon behalf of the respective parties by their respective attorneys of record, this 8th day of December, 1953.

Harry C. Weeks, Attorney of Record for all Petitioners. (Signed) Daniel A. Taylor, ATA, Attorney for Respondent.

[fol. 342] EXHIBIT A TO STIPULATION

Assignment of Oil Payment From Fleming Oil Company to Mrs. Marie Hildreth Cline

STATE OF TEXAS,
County of Howard:

Whereas, as shown by the records of Howard County, Texas, Fleming Oil Company, a partnership composed of Wm. Fleming, individually, as trustee, and as independent executor of the estate of Anna Maud Fleming, deceased, is the owner of one-half (1/2) of the seven-eighths (7/8) oil and gas leasehold estate covering the following described tracts of land in Howard County, Texas, to-wit:

(Stamps)

First Tract: North half of South half, Section 16, Block 30, Township 1 South, T. & P. Ry. Co. Survey, covered by oil and gas lease dated November 14, 1939, between Mrs. Ollie L. Denman, a widow, lessor, and Fleming-Kimbell Corporation, lessee, recorded in Vol. 106, Page 119, Deed Records, Howard County, Texas. (Known as O. L. Denman "C" Lease).

Second Tract: Northwest quarter of Section 10, Block 30, Township 1 South, T. & P. Ry. Co. Survey, covered by oil and gas lease dated September 21, 1928, executed by L. C. Denman and wife, Ollie Denman, lessors, and Empire Gas & Fuel Company, lessee, and recorded in Vol. 72, Page 336, Deed Records, Howard County, Texas. (Known as O. L. Denman "H" Lease).

[fol. 343] Third Tract: Southeast quarter and West half of Southwest quarter, Section 46, Block 30, Township 1 North, T. & P. Ry. Co. Survey, the oil and gas lease covering same being described in two assignments from the Iron Mountain Oil Company to F. H. E. Oil Company et al., dated April 7, 1941, and recorded in Vol. 109, Page 314, and Vol. 109, Page 315, Deed Records, Howard County, Texas, respectively. (Known as C. D. Read "A" and "B" Leases).

Fourth Tract: South half of Southeast quarter, Section 28, Block 30, Township 1 South, T. & P. Ry. Co. Survey, the oil and gas lease covering same being described in assignment from Iron Mountain Oil Company to F. H. E. Oil Company et al., dated April 4, 1941, and recorded in Vol. 109, Page 316, Deed Records, Howard County, Texas. (Known as D. H. Snyder "C" Lease).

Now, Therefore, in consideration of the sum of Ten Dollars ($10.00) cash and other good and valuable considerations to it in hand paid by Mrs. Marie Hildreth Cline, wife of G. L. Cline, out of her separate property and estate, the receipt of which is hereby acknowledged, the undersigned, Fleming Oil Company, a partnership as aforesaid, does hereby sell, assign, and convey unto the said Mrs. Marie Hildreth Cline, as a part of her separate property and estate, her heirs and assigns, the following described real property, to-wit:

An overriding royalty and mineral interest carved hereby out of the interest owned by Fleming Oil Company in each and all of the oil and gas leases described above, amount-[fol. 344] ing to an undivided 49/128ths interest in and to all the oil in, under, and that may be produced, saved and marketed from the above described tracts of land under the terms of the oil and gas leases covering same, until the grantee named above shall have received therefrom oil of the net value of One Hundred Forty-seven Thousand Dollars ($147,000.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $147,000.00 which may be unsatisfied from time to time.

This grant is made subject to the following conditions, limitations, and agreements:

(1) No interest in the gas or casinghead gas in, under, or produced and saved from said tracts, and no interest in

the personal property now or hereafter placed thereon is assigned or conveyed to grantee, this conveyance affecting the oil only.

(2) Grantee, her heirs and assigns, shall be entitled to receive the net sum of $147,000.00, plus an amount equal to five per cent (5%) interest as above provided, from the fractional part of the oil hereby conveyed, exclusive of, and in addition, to any gross production or severance taxes which may be deducted from grantee's part of the proceeds.

(3) This conveyance shall become effective as of seven o'clock, A. M., on the 1st day of June, 1948, and covers and includes 49/128ths of all oil in, under, and sold and marketed from the tracts above described, from and after said date and hour.

(4) All of the development and operating costs and expenses incurred in connection with said oil and gas leases [fol. 345] shall, as between the parties hereto, be borne exclusively by grantor, the fractional interest hereby conveyed to grantee being free and clear of all costs of development and operation.

(5) When and if the grantee herein, her heirs and assigns, have received from the fractional interest hereby assigned, oil of the net value of $147,000.00, plus an amount equal to five per cent (5%) interest as above provided, then the interest hereby conveyed to said grantee shall cease and terminate, and said interest shall revert to, and shall thereafter be owned by grantor, its successors, heirs or assigns; and grantee, her heirs and assigns, shall have no further interest in said oil and gas leasehold estates covering said land, or in the oil thereunder; and grantee, her heirs or assigns, shall, upon request, execute such instruments as may be necessary or proper to evidence this of record.

(6) The execution of this conveyance shall not impose upon grantor any obligation with respect to developing or operating the property covered hereby, nor shall it be implied herefrom that grantor is in anywise obligated to see that grantee receives oil aggregating the net value of $147,000.00, plus an amount equal to five per cent (5%) interest as above provided, or any lesser sum; but grantor does covenant and agree that grantee shall have the same but no greater right to require grantor to develop and operate said property in accordance with the terms of the

original leases upon said property as the original lessors therein, their heirs or assigns, might have or exercise.
[fol. 346] And, for the same consideration, the undersigned grantor, for itself and its successors, does hereby agree to warrant and forever defend the title to the interest herein granted to said grantee, her heirs and assigns, against the lawful claims and demands of all persons, whomsoever.

Dated this 19th day of May, A. D. 1948.

Fleming Oil Company, by Wm. Fleming, Individually, as Trustee, and as Independent Executor of the Estate of Anna Maud Fleming, Deceased.

EXHIBIT B TO STIPULATION

Assignment of Oil Payment from Wm. Fleming to Mrs. Marie Hildreth Cline

STATE OF NEW MEXICO,
County of Eddy:

Whereas the undersigned grantor, Wm. Fleming, is the owner of an undivided interest in certain oil and gas leases covering the following described land in Eddy County, New Mexico, to-wit:

The Southwest Quarter (SW ¼); the West one-half of the Southeast one-fourth (W ½ SE ¼); the Northeast one-fourth of the Southeast one-fourth (NE ¼ SE ¼); and Southwest one-fourth of the Northwest one-fourth (SW ¼ NW ¼), all in Section 2, Township 17 South, Range 30 East, N. M. P. M.;
[fol. 347] the oil and gas leases covering same being described in an assignment from L. H. Choate and wife, Lucille Choate, to Wm. Fleming, dated November 8, 1943, and recorded in Book 22, Page 139, Oil and Gas Records, Eddy County, New Mexico;

Now, Therefore, in consideration of the sum of Ten Dollars ($10.00) and other good and valuable considerations to him in hand paid by Mrs. Marie Hildreth Cline, the wife of G. L. Cline, out of her separate property and estate, the

receipt of which is hereby acknowledged, said Wm. Fleming does hereby sell, assign, and convey unto the said Mrs. Marie Hildreth Cline, as a part of her separate property and estate, and to her heirs and assigns, the following described real property, to-wit:

An overriding royalty and mineral interest carved hereby out of the interest owned by Wm. Fleming in each and all of the oil and gas leases described above, amounting to a .166668 interest in and to all the oil in, under, and that may be produced, saved and marketed from the above described tracts of land under the terms of the oil and gas leases covering same, until the grantee named above shall have received therefrom oil of the net value of Seventy three Thousand Five Hundred Dollars ($73,500.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $73,500.00 which may be unsatisfied from time to time.

This grant is made subject to the following conditions, limitations, and agreements:

(1) No interest in the gas or casinghead gas in, under, or produced and saved from said tracks, and no interest [fol. 348] in the personal property now or hereafter placed thereon is assigned or conveyed to grantee, this conveyance affecting the oil only.

(2) Grantee, her heirs and assigns, shall be entitled to receive the net sum of $73,500.00, plus an amount equal to five per cent (5%) interest as above provided, from the fractional part of the oil hereby conveyed, exclusive of, and in addition, to any gross production or severance taxes which may be deducted from grantee's part of the proceeds.

(3) This conveyance shall become effective as of seven o'clock, A. M., on the 1st day of June, 1948, and covers and includes .166668 of all oil in, under, and sold and marketed from the tracts above described, from and after said date and hour.

(4) All of the development and operating costs and expenses incurred in connection with said oil and gas leases shall, as between the parties hereto, be borne exclusively by grantor, the fractional interest hereby conveyed to grantee being free and clear of all costs of development and operation.

(5) When and if the grantee herein, her heirs and assigns, have received from the fractional interest hereby assigned, oil of the net value of $73,500.00, plus an amount equal to five per cent (5%) interest as above provided, then the interest hereby conveyed to said grantee shall cease and terminate, and said interest shall revert to, and shall thereafter be owned by grantor, his heirs or assigns; and grantee, her heirs and assigns, shall have no further interest in said oil and gas leasehold estates covering said [fol. 349] land, or in the oil thereunder; and grantee, her heirs or assigns, shall, upon request, execute such instruments as may be necessary or proper to evidence this of record.

(6) The execution of this conveyance shall not impose upon grantor any obligation with respect to developing or operating the property covered hereby, nor shall it be implied herefrom that grantor is in anywise obligated to see that grantee receives oil aggregating the net value of $73,500.00, plus an amount equal to five per cent (5%) interest as above provided, or any lesser sum; but grantor does covenant and agree that grantee shall have the same but no greater right to require grantor to develop and operate said property in accordance with the terms of the original leases upon said property as the original lessors therein, their heirs or assigns, might have or exercise.

And, for the same consideration, the undersigned grantor, for himself, his heirs and assigns, does hereby agree to warrant and forever defend the title to the interest herein granted to said grantee, her heirs and assigns, against the lawful claims and demands of all persons, whomsoever.

Dated this 19th day of May, A. D. 1948.

Wm. Fleming.

[fol. 350] EXHIBIT C TO STIPULATION

Assignment of Oil Payment from Wm. Fleming, Trustee, to Mrs. Marie Hildreth Cline.

STATE OF TEXAS,
County of Gregg:

Whereas, the undersigned grantor, Wm. Fleming, Trustee, as shown by the records of Gregg County, Texas, is the owner of an undivided interest in certain oil and gas

leases covering the following described tract of land in Gregg County, Texas, to-wit:

Forty-two and three-fourths (42¾) acres out of the G. W. Hooper Survey,

as described in that certain assignment dated Dec. 15, 1933, executed by E. J. Koenig to Wm. Fleming, Trustee, which assignment is of record in Vol. 156, Page 98, Deed Records of Gregg County, Texas. (Said tract is known as the J. M. Christian Lease).

Now, Therefore, in consideration of the sum of Ten Dollars ($10.00) and other good and valuable considerations to him in hand paid by Mrs. Marie Hildreth Cline, the wife of G. L. Cline, out of her separate property and estate, the receipt of which is hereby acknowledged, said Wm. Fleming does hereby sell, assign, and convey unto the said Mrs. Marie Hildreth Cline, as a part of her separate property and estate, and to her heirs and assigns, the following described real property, to-wit:

An overriding royalty and mineral interest carved hereby [fol. 351] out of the interest owned by Wm. Fleming, Trustee, in each and all of the oil and gas leases described above, amounting to an undivided 6/100ths interest in and to 7/8ths of all the oil in, under, and that may be produced, saved and marketed from the above described tract of land under the terms of the oil and gas leases covering same, until the grantee named above shall have received therefrom (in oil) of the net value of Forty-nine Thousand Dollars ($49,000.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $49,000.00 which may be unsatisfied from time to time.

This grant is made subject to the following conditions, limitations, and agreements:

(1) No interest in the gas or casinghead gas in, under, or produced and saved from said tract, and no interest in the personal property now or hereafter placed therein is assigned or conveyed to grantee, this conveyance affecting the oil only.

(2) Grantee, her heirs and assigns, shall be entitled to receive the net sum of $49,000.00, plus an amount equal to five per cent (5%) interest as above provided, from the fractional part of the oil hereby conveyed, exclusive of, and in addition, to any gross production or severance taxes which may be deducted from grantee's part of the proceeds.

(3) This conveyance shall become effective as of seven o'clock, A.M., on the 1st day of June, 1948, and covers and includes 6 100ths of 7sths of all oil in, under, and sold and marketed from the tract above described, from and after said date and hour.

[fol. 352] (4) All of the development and operating costs and expenses incurred in connection with said oil and gas leases shall, as between the parties hereto, be borne exclusively by grantor, the fractional interest hereby conveyed to grantee being free and clear of all costs of development and operation.

(5) When and if the grantee herein, her heirs and assigns, have received from the fractional interest hereby assigned, oil of the net value of $49,000.00, plus an amount equal to five per cent (5%) interest as above provided, then the interest hereby conveyed to said grantee shall cease and terminate, and said interest shall revert to, and shall thereafter be owned by grantor, his heirs or assigns; and grantee, her heirs and assigns, shall have no further interest in said oil and gas leasehold estates covering said land, or in the oil thereunder; and grantee, her heirs or assigns, shall, upon request, execute such instruments as may be necessary or proper to evidence this of record.

(6) The execution of this conveyance shall not impose upon grantor any obligation with respect to developing or operating the property covered hereby, nor shall it be implied herefrom that grantor is in anywise obligated to see that grantee receives oil aggregating the net value of $49,000.00, plus an amount equal to five per cent (5%) interest as above provided, or any lesser sum; but grantor does covenant and agree that grantee shall have the same but no greater right to require grantor to develop and operate said property in accordance with the terms of the original leases upon said property as the original lessors therein, their heirs or assigns, might have or exercise.

[fol. 353] And, for the same consideration, the undersigned grantor, for himself, his heirs, successors, and assigns, does hereby agree to warrant and forever defend the title to the interest herein granted to said granted, her heirs and assigns, against the lawful claims and demands of all persons, whomsoever.

Dated this 19th day of May, A. D. 1948

Wm. Fleming, Trustee.

EXHIBIT D TO STIPULATION

Mineral Deed

From Wm. Fleming, Trustee, To Mrs. Marie Hildreth Cline.

STATE OF TEXAS,
County of Cooke:

Know All Men By These Presents:

That Wm. Fleming, Trustee, of Tarrant County, Texas, for and in consideration of Ten Dollars ($10.00) and other good and valuable considerations to him in hand paid out of her separate property and estate by Mrs. Marie Hildreth Cline, wife of G. L. Cline, hereinafter called grantee, the receipt of which is hereby acknowledged, does, subject to the conditions and limitations set forth below, grant, sell, and convey unto the said grantee, as a part of her separate property and estate, an undivided 32.3535/400ths royalty interest in and to all of the oil in, under, and that may be produced from the following described land situated in Cooke County, Texas, to-wit:

[fol. 354] The East 400 acres of the West 700 acres of a 973.7 acre tract out of the Conrad Furnash Survey, which 973.7 acres are described by metes and bounds in that certain mineral deed dated October 10, 1946, executed by B. V. Whitfield to Wm. Fleming, Trustee, which deed is of record in Vol. 315, Page 287, Deed Records, Cooke County, Texas;

Said land being now under an oil and gas lease, it is understood and agreed that this sale is made subject to the terms of said lease, but covers and includes 32.3535/400ths

of the 1/8th royalty on oil due and to be paid under the terms of said lease, insofar as it covers the above described land, until the grantee named above shall have received oil of the net value of Twenty-four Thousand Five Hundred Dollars ($24,500.00), plus an amount equal to five per cent (5%) interest per annum from May 19, 1948, on the portions of said $24,500.00 which may be unsatisfied from time to time.

This grant is made subject to the following conditions, limitations, and agreements:

(1) No interest in the gas or casinghead gas in, under, or produced and saved from said tracts is assigned or conveyed to grantee, this conveyance affecting the oil only.

(2) Grantee, her heirs and assigns, shall be entitled to receive the net sum of $24,500.00, plus an amount equal to five per cent (5%) interest as above provided, from the fractional part of the oil hereby conveyed, exclusive of, and in addition, to any gross production or severance taxes which may be deducted from grantee's part of the proceeds.

[fol. 355] (3) This conveyance shall become effective as of seven o'clock, A. M., on the 1st day of June, 1948, and covers and includes 32.3535 400ths of 1/8th of all oil in, under, and sold and marketed from the tract above described, from and after said date and hour.

(4) When and if the grantee herein, her heirs and assigns, have received from the fractional interest hereby conveyed, oil of the net value of $24,500.00, plus an amount equal to five per cent (5%) interest per annum as above provided, then the interest hereby conveyed to said grantee shall cease and terminate, and said interest shall revert to, and shall thereafter be owned by grantor, his heirs, successors and assigns; and grantee, her heirs and assigns shall have no further interest in said oil in, under, or that may be produced from said land; and grantee, her heirs and assigns, shall, upon request, execute such instruments as may be necessary or proper to evidence this of record.

And, for the same consideration, the undersigned grantor, for himself, his heirs, successors and assigns, does hereby agree to warrant and forever defend the title to the interest herein granted to said grantee, her heirs and assigns,

against the lawful claims and demands of all persons, whomsoever.

Dated this 19th day of May, A. D., 1948.

Wm. Fleming, Trustee.

[fol. 356] EXHIBIT F TO STIPULATION

Conveyance From F. Howard Walsh To C. C. Cross.

THE STATE OF TEXAS,
County of Ward:

Know All Men By These Presents:

Whereas the undersigned grantor, F. Howard Walsh, is the owner, as shown by the records of Ward County, of all or an undivided interest in the oil and gas leasehold estates covering the following described tracts and oil and gas leases located in Ward County, Texas, to-wit:

(a) Walsh's "Killough" Lease, covering all of the NE 2 of the N 4 of Sec. 29, Blk. B-29, Public School Land, more particularly described in assignment from Atlantic Oil Producing Company to F. H. E. Oil Company, dated April 10, 1936, and recorded in Vol. 66, Page 396, Deed Records of Ward County, Texas;

(b) Walsh's "Richter A" Lease, "Richter B" Lease, and "Richter C" Lease, covering four 20-acre tracts described in that certain assignment from F. Howard Walsh to Broadway Baptist Church, dated June 11, 1948, and of record in Vol. 120, Pages 85-7, Assignment Records of Ward County, Texas;

(c) Walsh's "Green" Lease, being the W/4 of the N/4 and the N/4 of the W/4 and the NW 10 acres of the S/4 of the N/4 of Sec. 29, Block B-29, Public School Land, being the tracts described in the assignment from F. H. E. Oil Company to F. Howard Walsh, dated October 4, 1940, and recorded in Vol. 89, Page 433, Assignment Records of Ward County.

[fol. 357] (d) Walsh's "Maxwell B" Lease, covering the SE/2 of the N/4 of Sec. 30, Bloack B-29, Public School Land, containing 53 acres, more or less, described in assign-

ment from F. H. E. Oil Company to F. Howard Walsh, dated October 4, 1940, and recorded in Vol. 89, Page 438, Assignment Records of Ward County;

(e) Walsh's "Maxwell A" Lease, covering 10 acres of land in the form of a square, located in the North corner of the SW 2 of the W 4 of Sec. 30, Block B-29, Public School Land, being the tract described in the assignment from F. H. E. Oil Company to F. Howard Walsh, dated October 4, 1940, and recorded in Vol. 89, Page 437, Assignment Records of Ward County.

(f) Walsh's "Wallis" Lease, covering the Southwesterly 175 acres of Sec. 19, Block 34, H. & T. C. Ry. Co. Survey, Ward County, except 40 acres out of the West corner of said Sec. 19, and being the tract described and conveyed in the assignment from F. H. E. Oil Company to F. Howard Walsh, dated October 4, 1940, and recorded in Vol. 89, Page 447, Assignment Records of Ward County,

reference being here made to each of said recorded instruments above referred to, for a more particular description of said oil and gas leases and the tracts covered thereby; and

Whereas, in trade and exchange for the interests herein conveyed, C. C. Cross has this day conveyed to said Walsh certain real property located in Tarrant County, Texas;

Now, Therefore, in consideration of the premises, the undersigned grantor, F. Howard Walsh, does hereby, sub- [fol. 358] ject to the conditions and limitations hereinafter set out, bargain, sell, assign and convey unto C. C. Cross, of Tarrant County, Texas, his heirs and assigns, the following described overriding royalty and mineral interests carved out of the interests owned by the undersigned grantor in and to the oil and gas leases and leasehold estates, insofar as they cover the tracts of land and leases described above, such interests herein conveyed being the following fractional parts of the oil in, under, or upon, or that may be produced from such tracts of land under the terms of said leases, to-wit:

(a) 1/4 of 7/8 of such oil, insofar as all of the tracts and leases in Ward County above described are concerned, save and except Walsh's "Killough" Lease; and

(b) 1/4 of 7/16 of such oil, insofar as such Killough Lease is concerned.

This grant is made subject to the following conditions and limitations, to wit:

(a) No interest in gas, casinghead gas or any other mineral except liquid petroleum shall be conveyed and assigned.

(b) All of the development and operating costs and expenses incurred in developing and operating said properties shall be borne exclusively by Walsh, insofar as the parties hereto are concerned.

(c) When and if Cross, or his heirs and assigns, shall have received, under the terms of said conveyance and assignment, oil of the net value of Sixty Five Thousand [fol. 359] and No 100 Dollars ($65,000.00), plus interest at the rate of seven (7) per cent per annum on the balances unpaid from time to time (exclusive of gross production taxes, which may be deducted from Cross's part of the oil), —then Cross shall have no further interest in said oil and gas leases or leasehold estate, and the oil then remaining in, under or upon said tracts of land, or thereafter produced therefrom; and the interests hereby conveyed shall automatically revert to Walsh, his heirs and assigns.

(d) Walsh shall pay all ad valorem taxes hereafter to be imposed upon the interests herein conveyed to Cross.

(e) This conveyance shall be effective as of seven o'clock, A. M., on October 1, 1949, and covers and includes the above described fractional parts of the oil produced, saved and sold from and after that date and hour.

Executed this 5th day of October, A. D., 1949.

F. Howard Walsh.

[fol. 360] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 361] Minute Entry of Argument and Submission—December 3, 1956.

(omitted in printing)

[fol. 362] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 15981

WM. FLEMING AND BESSIE M. FLEMING, (Husband and Wife), F. Howard Walsh and Mary D. Walsh, (Husband and Wife) and Mary D. Fleming Walsh, Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

versus

WM. FLEMING AND BESSIE M. FLEMING, (Husband and Wife), F. Howard Walsh and Mary D. Walsh, (Husband and Wife) and Mary D. Fleming Walsh, Respondents.

Petitions for Review of Decisions of The Tax Court of the United States (District of Texas).

OPINION—February 1, 1957

Before: HUTCHESON, Chief Judge, and HOLMES and BORAH, Circuit Judges.

[fol. 363] HUTCHESON, *Chief Judge:* These consolidated appeals, brought by the taxpayers and commissioner, respectively, from decisions of the Tax Court,[1] involve income taxes for 1948 and 1949.

Three issues,[2] corresponding to the issues decided below,

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[1] 24 T.C. 818.

[2] These are: (1) The taxpayers exchange limited overriding royalty or oil payment interests (carved by them out of larger oil and gas interests) for, in one case, a ranch; and, in the other, urban business property.

The question is whether the exchanged properties were of "like kind" within the purview of Sec. 112(b)(1) Internal Revenue Code of 1939, so that, all other requirements

are presented for review, Issues Nos. 1 and 2 on the taxpayers', and Issue No. 3 on the commissioner's petition.

Submitted on stipulated facts,[3] there were findings in accordance therewith, and a decision against taxpayers [fol. 364] on the two issues appealed by them, and in their favor on the issue appealed by the commissioner.

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of said section being met, no taxable gain from the exchanges is to be recognized.

(2) Taxpayer, Mrs. Walsh, in 1943, agreed with a life insurance company that the proceeds of a 10 year endowment life insurance policy on her life—maturing in 1945—should, after such maturity, be held by the insurance company for an indefinite period of time, not within her control, and, during the first ten years of this extended period, improved with interest, after which interest on the total amount was to be paid to her periodically for the remainder of her life and thereafter as she directed in the agreement.

The question is whether the amounts of the interest improvements in 1948 and 1949, not paid or subject to withdrawal in those years, were nevertheless constructively received during said years by Mr. and Mrs. Walsh—"cash basis" taxpayers.

(3) If the first question presented by the taxpayers is decided adversely to them, then should the Tax Court's holding that said exchanges produced long-term capital gain be affirmed, or should the Commissioner be sustained in his contention that the taxpayers merely assigned future income and thereby received ordinary depletable income.

[3] Those pertinent to the first and third issues may be thus summarized:

All of the tax returns involved were filed upon the cash receipt and disbursement basis. Wm. Fleming, the partnership, Fleming Oil Co., Wm. Fleming, Trustee, and F. Howard Walsh, and each of them, were, among other activities, engaged in the business of producing oil and gas. All of the oil and gas properties held by any of those just named and involved in this proceeding had been held by them for several years for productive use in their said trade or business and not for sale.

On May 19, 1948, the Flemings acquired from Mrs. Cline—in the proportions of 50%, 25% and 25%—the fee simple title to some 2994.5 acres of ranching land situated in

[fol. 365] On their first question, taxpayers plant themselves firmly on two decisions of this court, *Commissioner* v. [fol. 366] *Chrichton*, 122 F(2) 181, holding that a city lot and mineral interests, and *Fleming v. Campbell*, 205 F(2)

Parker and Tarrant Counties, Texas, and thereafter held said lands for investment and not for sale.

The sole consideration given Mrs. Cline for this ranch was the assignment to her by the Flemings of limited overriding royalty or oil payment interests in various producing oil and gas properties then owned by the respective transferrors, and by the terms of the transfer Mrs. Cline became entitled to various fractions of the oil thereafter to be produced from the properties until she had received: from the Fleming Oil Company assignment—oil of the value of $147,000; from the Wm. Fleming assignment—oil of the value of $73,500; from the two Wm. Fleming Trustee assignments—oil of the value of $49,000 and $24,500, respectively, plus the same interest-factor in all. One of the Trustees' oil *payment assignments was out of leasehold interests, the other out of a royalty interest.*

The assignment from Fleming Oil Co. is typical and only its pertinent terms will be set out. It involved four ordinary commercial oil and gas leaseholds in which Fleming Oil Company was then the owner of an undivided one-half interest; and recited that for a valuable consideration Fleming Oil Company conveyed to Mrs. Cline:

> "The following described real property, to-wit, An overriding royalty or mineral interest carved out of the interest owned by Fleming Oil Company in each and all of the oil and gas leases above described, amounting to an undivided 48/128 interest in and to all of the oil in, under and that may be produced, saved and marketed from the above described tracts of land under the terms of the oil and gas leases covering the same, until the grantee above named shall have received therefrom oil of the net value of $147,000, plus an amount equal to 5% interest per annum from May 19, 1948, on the portions of the said $147,000 which may be unsatisfied from time to time."

The instrument further provided that no interest in gas, casinghead gas or in the personal property then on or there-

[fol. 367] 548, holding that oil payments and perpetual mineral or royalty interests, were properties of like kind. Insisting that these cases, holding in accordance with long standing regulations that the statutory phrase "like kind"

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after placed upon the property was conveyed; that grantee was to be entitled to receive the amount specified from the fractional part of the oil conveyed in addition to such gross production or severance taxes as might be imposed thereupon; that the conveyance was effective June 1, 1948; that all development and operating costs and expenses were to be borne by Fleming Oil Company; and that, when the grantee had received oil of the net value specified, her interest was to terminate. The instrument also provided:

> "The execution of this conveyance shall not impose upon grantor any obligation with respect to developing or operating the property covered hereby, nor shall it be implied herefrom the grantor is in anywise obligated to see that grantee receives oil aggregating the net value of $147,000, plus an amount equal to 5% as above provided, or any lesser sum; but grantor does covenant and agree that grantee shall have the same but no greater right to require the grantor to develop and operate said property, in accordance with the terms of the original lease upon said property, as the original lessors therein, their heirs or assigns, might have or exercise."

On Oct. 5, 1949, taxpayer F. Howard Walsh, in accordance with an existing agreement so to do, acquired from one C. C. Cross the fee simple title to revenue producing business real estate located in Fort Worth, Texas, and as the sole consideration for this conveyance, conveyed to Cross a limited overriding royalty or oil payment interest out of some six producing oil and gas leases in which Walsh then owned interests. The conveyance was in terms substantially similar to the terms of the Fleming Oil Company conveyance just summarized and entitled Cross to the specified fractions of oil, when, as and if produced, until he had received, free and clear of all costs and expenses, oil of the value of $65,000, plus an amount equal to interest on monthly declining balances at the rate of 7% per annum. Walsh acquired and has held the aforesaid business prop-

refers to the nature or character of the property interest and not to its grade or quality, they urge upon us that the exchanged properties, mineral interests for ranch lands in

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erty for investment and not for sale. All of the oil and gas leases involved were ordinary commercial oil and gas leases.

The properties acquired by the respective taxpayers in these exchanges had a fair market value equal to the face amount of the respective oil payments conveyed therefor.

It could be estimated at the time the case was submitted to the Tax Court that the oil payment assigned by Fleming Oil Co. would pay out in approximately 5 years and 8 months from its effective date; that from Wm. Fleming, in from 10 to 12 years from its effective date; and each of the oil payments assigned by Wm. Fleming, Trustee, in from 7 to 8 years from their respective dates. Likewise, it could have been estimated that the F. Howard Walsh oil payment would pay out in approximately 3½ years from its effective date.

Those pertinent to the second issue are:

The other issue presented involves Mr. and Mrs. Walsh only, and as to this issue the record discloses that on March 28, 1935 Mrs. Walsh (then Mary D. Fleming) acquired from Southwestern Life Ins. Co. a 10 year endowment policy in consideration of ten annual premiums of $2,245.75 each, which were duly paid. The policy provided that if the insured lived to the policy's maturity (March 28, 1945) the insured might within 31 days after such maturity select one of the following options of settlement:

1. $25,000 in cash;
2. $16,400 in cash and a paid up policy for $25,000; or
3. A paid up policy for $72,825.

On September 15, 1943—some year and a half before the policy matured—Mrs. Walsh entered into an agreement with the insurance company by which, at the maturity of the policy, the payment of the $25,000 proceeds was to be deferred—

> "* * * until paid as herein provided:
>
> "Interest on the unpaid portion of such sum at the guaranteed rate of three and one-half per cent per annum, and such additional interest, if any, as may be apportioned thereto by the Company from surplus in-

the Fleming transfers and mineral interests for urban real estate in the Walsh transfers, were of like kind.

The tax court judge, though agreeing that the oil payment assignments constituted mineral interests and, there-

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terest earnings, shall be added to the principal on March 28, each year, until March 28, 1955, and thereafter paid monthly as it accrues, subject to the limitation hereinafter specified, the first payment to be made April 28, 1955. Such interest shall be paid to me, if living, otherwise to the payee or payees as hereinafter designated."

There followed in the agreement provisions for payment after Mrs. Walsh's death to her children and grandchildren, and the instrument concluded:

> "It is understood and agreed that the Agreement to be issued and dated March 28, 1945, pursuant to this request, cannot be changed or amended, but the beneficiary may be changed with the consent of William Fleming, my father, upon written request and proper endorsement thereon. All payments provided herein shall be payable at the Home Office of the Company in the City of Dallas, Texas."

In accordance with this, on March 28, 1945, the Life Insurance Company issued an instrument acknowledging the maturity of the policy and that in satisfaction of the obligations of the policy it—

> "Promises to pay at its Home Office in the City of Dallas, Texas, the proceeds of said policy in accordance with the option method of settlement selected by Mary D. Fleming Walsh, the insured, in writing, a photostatic copy of such election being hereto attached and made a part hereof."

Nothing was paid to Mrs. Walsh, or anyone else, by the insurance company under said settlement agreement, during the years 1948 and 1949, and Mr. and Mrs. Walsh reported no income from that source in those years. But in determining the deficiencies due by Mr. and Mrs. Walsh for 1948 and 1949 the Commissioner treated as interest income constructively received by them $2,132.18 and $2,206.81, respectively; these amounts being the amounts added to the principal due under the interest provision above quoted from the settlement agreement.

fore, interests in land, was of the opinion that, because the duration of these mineral interests was measured by and limited to oil of the value named in the assignments, the properties exchanged were not of like kind. In short, holding that one was an unlimited, the other a limited, interest in lands, he thought that the sufficient distinction between this and the Chrichton case was that the mineral interest exchanged for urban lands there was an unlimited and not a limited, mineral interest. He thought that the Fleming case could be distinguished because, while it involved a limited mineral interest, a limited overriding royalty or oil payment, the exchange there was of that interest solely for undivided fractional oil, gas and other mineral interests. To which the taxpayers reply that if, as was held in the Chrichton case, the exchange of an unlimited mineral [fol. 368] interest for urban property was an exchange of like kind and in the Fleming case that an exchange of limited, for unlimited, mineral interests was also an exchange of like kind, it must follow, upon the principle that things equal to the same thing are equal to each other, that any of the properties involved in the two exchanges, if exchanged for any involved in the other, would result in exchanges of like kind.

On this issue, Judge Borah dissenting, we agree with taxpayers.

In *Commissioner v. Chrichton*, 122 F(2) 181, we pointed out that the invoked section, 112 (b)(1), is so general in its terms as to render an interpretative regulation appropriate and that the Treasury regulation invoked and sought to be applied was appropriate and valid.

In *Fleming v. Campbell*, 205 F(2) at p. 549, quoting in the margin from the Chrichton case,[4] we rejected the argu-

[4] "* * * the regulation and the interpretation under it, leave in no doubt that no gain or loss is realized by one, other than a dealer, from an exchange of real estate for other real estate, and that the distinction intended and made by the statute is the broad one between classes and characters of properties, for instance, between real and personal property. It was not intended to draw any distinction between parcels of real property however dissimiliar they may be in location, in attributes and in capacities for profitable use." Com. v. Crichton, 121 F.(2) at p. 182.

ment of the collector "that the mineral interest in the Ector County lands was an interest in fee and that in the Gregg County lands, for which it was exchanged, was a leasehold of a fee which does not have thirty or more years to run, and that, therefore, under the regulation the [fol. 369] interests exchanged were not of like kind", saying:

> "We cannot agree. In the first place, both interests exchanged were interests in land. (citing in note 5 many cases). In the second place, neither interest was a 'leasehold of a fee' in the sense in which that term is used in the regulation. Both were interests in minerals in place. Both were therefore interests in land, interests not in personal but in real property, in short, real rights."

We are, therefore of the opinion that, in those two cases, this court, in principle, decided the question presented here, and that, upon the authority of those decisions, the judgment of the tax court on the first issue must be reversed.

If we assume that we are in error in this view, and we, therefore, reach the third issue, note 2, *supra*, raised on the commissioner's appeal, that the tax court erred in holding that the transactions were exchanges of property giving rise to capital gains treatment and not anticipatory assignments of income, we find ourselves in agreement with the tax court, and, for the reasons set out in *Scofield v. O'Connor* and *Lake v. Commissioner*, this day decided, we affirm its judgment on this issue.

We come then to a consideration of the taxpayers' second issue, raised by the Walsh appeal, that the tax court erred in holding that the amounts added in 1948 and 1949 under the amended contract with the insurance company, though not paid to taxpayers in those years, were subject to tax [fol. 370] payers' withdrawal and, therefore, constructively received. The tax court, stating:

> "Petitioner [Mrs. Walsh] has deliberately turned her back on income, and has in effect selected the year in which she will report it. This she may not do. Further, the whole arrangement for the nonacceptance of income was voluntary on petitioner's part, she was

> in no way forced to surrender her right to the proceeds of the matured policy, and she could have had the interest paid to her currently as she did in the second agreement."

concluded:

> "Petitioner, a cash basis taxpayer, cannot escape income tax by directing that accrued interest be accumulated for her benefit in the future. See Theodore R. Bayard, 16 T.C. 1345." "

Here taxpayers insist that the commissioner and the tax court misunderstand the nature and effect of Mrs. Walsh's agreement and the law applicable thereto. Pointing out that under a valid and binding agreement made some eighteen months before the maturity of the policy and effecting a novation of the original agreement, the parties changed the terms of their contract, the taxpayers, citing *Commissioner v. Oates*, 207 F(2) 711 as precisely in point, insist that the commissioner and the court are undertaking to make for parties, who were competent to make and had made a valid agreement, an agreement that they did not make.

Pointing to the difference between the facts of this case and those dealt with in our case of *Williams v. United* [fol. 371] *States*, 219 F(2) 523; that there the taxpayer gained nothing by his agreement for the voluntary escrow of moneys admittedly due and payable to him, except, if the plan was successful, a reduction of his taxes and that this court correctly held that moneys so voluntarily escrowed by him were constructively received by him in the year of the escrow; whereas, in this case, there was a real contract in which both contracting parties obtained benefits; taxpayers insist that the Williams case is not against, but is in support of their contention.

We agree with taxpayers' contention. In the Williams case, the district judge and this court held that the transaction was not an installment sale but a completed one, the gain from which was immediately available and, therefore, taxable, to the seller in the year of its making, and the taxpayer could not, by voluntarily escrowing the pur-

chase price under an agreement that he should receive it in installments, defer payment of the taxes due on the sale.

There is nothing in this record indicating anything other than arms length business transactions between Mrs. Walsh and the company, a contract maturing in 1945, and an agreement entered into eighteen months before its maturity by which, instead of receiving the whole sum in 1945, she agreed with the company that it would hold the funds until 1955, another ten years, adding to the principal amount each year interest at an agreed figure plus such additional amounts as might be appropriated each year from the life insurance company's excess earnings. As a result of the [fol. 372] agreement, the amount of the interest added to the principal in 1948 and 1949 was greatly in excess of the guaranteed rate of $3\frac{1}{2}$ percent. In short, in 1943, when her new contract was made, Mrs. Walsh contracted for a greater rate than would have otherwise been available to her if she had continued to receive only current interest payments. In the years before this court, 1948 and 1949, Mrs. Walsh not only received nothing, she had no right to receive anything.

The judgment against taxpayers on this issue must be reversed.

The judgment of the tax court is Affirmed on the commissioner's appeal. On the taxpayers' appeal, it is Reversed and the cause is Remanded for tax redetermination in accordance herewith.

Judge Barah dissents from the decision on the first issue note 2 *supra*.

[fol. 373] In United States Court of Appeals for the Fifth Circuit

Wm. Fleming and Bessie M. Fleming (Husband and Wife), F. Howard Walsh and Mary D. Walsh (Husband and Wife), and Mary D. Fleming Walsh,

versus

Commissioner of Internal Revenue

No. 15981

Commissioner of Internal Revenue,

versus

Wm. Fleming and Bessie M. Fleming (Husband and Wife), F. Howard Walsh and Mary D. Walsh (Husband and Wife), and Mary D. Fleming Walsh.

Judgment—February 1, 1957

This cause came on to be heard on the petitions of Wm. Fleming and Bessie M. Fleming (Husband and Wife) and F. Howard Walsh and Mary D. Walsh (Husband and Wife), and Mary D. Fleming Walsh, and Commissioner of Internal Revenue for a review of decisions of The Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the judgment of the said Tax Court on the Commissioner's appeal in this cause be, and the same is hereby, affirmed; and on the Taxpayers' appeal, that said judgment be, and it is hereby, reversed; and the cause is remanded to the said Tax Court for tax redetermination in accordance with the opinion of this Court.

"Borah, Circuit Judge, dissents from the decision on the first issue note 2 supra."

[fol. 374] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 375] [Caption omitted.]

[fol. 376] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16,055

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

versus

JOHN WEATHER AND NELL WEATHER, Respondents

Tax Court Docket No. 38,267

PETITIONER'S DESIGNATION AS TO PRINTING RECORD—Filed: April 26, 1956

The petitioner, the Commissioner of Internal Revenue, requests that only the following designated portions of the record be printed:

Docket entries; Amended petition; Answer to amended petition.

Report of proceedings dated June 14, 1954, only the following portions:

Beginning with the third line on page 32 and continuing through the first sentence, line 4, page 33;

Beginning with the ninth line on page 48 and continuing through line 21 on page 48;

[fol. 377] Stipulation of facts, from the beginning and continuing through paragraph 16, plus the signatures on last page;

Memorandum findings of fact, from the beginning and continuing through the fifth line on page 5 (down to "Issue II");

Decision; Petition for review and proofs of service; Court Order re transmission of original exhibits, original briefs and the official reports of proceedings.

Dated May 20, 1956.

(Signed) Charles K. Rice, Assistant Attorney General, Counsel for the Petitioner.

[fol. 378] IN THE TAX COURT OF THE UNITED STATES

Docket No. 38267

JOHN WEATHER AND NELL WEATHER, Husband and wife, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

APPEARANCES:

For Petitioner: (Withdrawn), (Leslie E. Martlew, Esq.), (Withdrawn), (Robert Ash, Esq.), Allen E. Pye, Esq.

For Respondent: John P. Higgins, Esq., R. C. Whitley, Esq.

DOCKET ENTRIES

1952

Jan. 4—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 5—Copy of petition served on General Counsel.

Feb. 15—Answer filed by General Counsel.

Feb. 15—Request for hearing in Dallas, Texas filed by General Counsel.

[fol. 379] Feb. 21—Notice issued placing proceeding on Dallas, Texas calendar. Service of answer and request made.

1953

Jan. 2—Hearing set February 24, 1953, Dallas, Texas.

Feb. 20—Entry of appearance of Robert Ash as counsel filed.

Feb. 20—Motion to continue to the next Dallas calendar filed by petitioner. Granted.

Jul. 29—Hearing set October 19, 1953, Dallas, Texas.

Oct. 14—Motion for continuance to the next Dallas calendar filed by taxpayer. Agreed to. 10 14 53 Granted.

1954

Mar. 8—Hearing set June 14, 1954, Dallas, Texas.

Apr. 13—Motion for withdrawal of E. E. Martlew as counsel filed. Granted.

1954

Apr. 13—Entry of appearance of Allen E. Pye as counsel filed.

Apr. 29—Motion to withdraw as counsel Robert Ash, filed. 4-30-54 Granted.

May 17—Notice changing Courtroom.

May 21—Motion for leave to amend petition, amended petition lodged, filed by taxpayer.

May 21—Motion for leave to amend petition granted, amended petition filed.

May 24—Copy of motion and amendment served on General Counsel.

June 14—Hearing had before Judge Johnson, on merits. Permission granted respondent to file answer to amended [fol. 380] petition, filed at hearing. Submitted. Stipulation of facts and exhibits A-1 to JJ-36 attached filed. Briefs due July 29, 1954. Replies due August 30, 1954.

Jul. 27—Transcript of hearing 6-14-54 filed.

Jul. 28—Motion for extension to August 12, 1954 to file brief filed by General Counsel. 7-29-54 Granted.

Aug. 9—Brief filed by taxpayer. 8-13-54 Copy served.

Aug. 12—Brief filed by General Counsel. 8-13-54 Copy served.

Sept. 13—Petitioner's reply brief filed. Copy served.

1955

Apr. 26—Memorandum findings of fact and opinion filed, Johnson, Judge. Decision will be entered under Rule 50. Copy served 4-26-55.

Jun. 21—Motion for additional findings of fact with attached memorandum in support thereof filed by petitioner.

Jul. 13—Order, denying petitioner's motion of June 21, 1955, entered.

Jul. 22—Petitioner's computation filed. Copy served.

Jul. 22—Hearing set August 17, 1955, Washington, D. C., (Rule 50). Copy served.

Aug. 2—Respondent's computation filed.

Aug. 8—Memorandum in support of respondent's objections and computation filed by General Counsel. Copy served 8-10-55.

Aug. 17—Hearing had before Judge Turner, on settlement. Referred to Judge Johnson.

Aug. 17—Hearing had before Judge Johnson, on settlement. C.A.V.

1955

Aug. 18—Decision entered, Judge Johnson, Div. 10.
[fol. 381] Nov. 10—Petition for review by United States Court of Appeals, Fifth Circuit, with assignments of error filed by respondent.

Nov. 25—Proof of service filed. Petitioner and attorney. (2).

Dec. 21—Motion for extension to March 9, 1956 for preparation of the evidence, transmission and delivery of the record filed by respondent.

Dec. 22—Order extending time to March 9, 1956 for preparation of the evidence, transmission and delivery of the record, entered.

1956

Feb. 14—Motion for extension of time to April 23, 1956 for preparation of the evidence, transmission and delivery of the record filed by respondent.

Feb. 15—Order, granting extension to April 23, 1956 to prepare, transmit and deliver the record, entered.

Mar. 5—Transcript of hearing 8-17-55 filed.

Mar. 29—Certified copy of order of Court of Appeals, Fifth Circuit, directing the Tax Court to: (1) transmit all original exhibits received in evidence, including joint exhibits A-1 thru JJ-36, attached to stipulation of facts and all original briefs to Appellate Court ten days before hearing; and (2) include as part of the transcript of record the original official report of this proceeding, including the oral testimony, in lieu of a narrative statement of evidence, and the original official report of the hearing under Rule 50, filed.

Apr. 5—Agreed praecipe for record filed by respondent.

[fol. 382] In The Tax Court of The United States.
Washington

[Title omitted]

Amended Petition—Filed and received May 21, 1954

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commis-

sioner of Internal Revenue in his notice of deficiency (Internal Revenue Agent in Charge, Dallas, Texas), dated October 9, 1951, and as a basis of this proceeding, allege as follows:

1

Petitioners, husband and wife, resided at 25 Covington Drive, Longview, Texas. The petitioners filed a joint income tax return for the taxable years ended December 31, 1948, and December 31, 1949, with the Collector of Internal Revenue for Second Texas District, in Dallas, Texas.

[fol. 383] 2

The notice of deficiency, a copy of which is attached hereto and made a part of this petition by reference, is dated October 9, 1951.

3

The taxes in controversy are income taxes for the taxable years ended December 31, 1948, and December 31, 1949, in the amounts of $112,715.34 and $72,404.66, respectively.

4

The determination of the taxes set forth in the notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously increased petitioners' distributable share of the partnership income from the George & Wrather Drilling Company, Mt. Carmel, Illinois, by the amount of $104,218.75, as the result of treating the gain from the sale of oil payments as ordinary income rather than as gain from the sale of capital assets held for more than six months.

(b) The Commissioner erred in determining Bad Debts, as set forth in said notice of deficiency for the taxable years ended December 31, 1948 and 1949, constituted capital investment with a corresponding capital loss upon the sale or worthlessness of the investment.

[fol. 384] 5

The facts upon which the petitioners rely in this proceeding are as follows:

(a) By conveyance dated August 16, 1948, T. W. George, Edmee May George, Fred B. Wimberly, Virginia Wimberly,

and the petitioners, individually and doing business as "George & Wrather Drilling Company," sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment in the amount of $12,500.00, to be paid out of 9/10 of 5/16 of 7/8 of all the oil produced and saved from property known as the Kieffer "A" Lease, said lease having been acquired by the grantors in 1947.

(b) By conveyance dated August 16, 1948, T. W. George, Edmee May George, Fred B. Wimberly, Virginia Wimberly, and the petitioners, individually and doing business as "George & Wrather Drilling Company," sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment in the amount of $155,000.00, to be paid out of 9/10 of 5/16 of 7/8 of all the oil produced and saved from property known as the Kieffer "A" Lease, said lease having been acquired by the grantors in 1947.

(c) By conveyance dated August 16, 1947, T. W. George, Edmee May George, Fred B. Wimberly, Virginia Wimberly, and the petitioners, individually and doing business as "George and Wrather Drilling Company," sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment in the amount of $130,000.00 to be paid out of 9/10 of 7/24 of 7/8 of all the oil produced and [fol. 385] saved from the property known as the Brown Lease, said lease having been acquired by the grantors in 1946.

(d) The aforementioned sales of property resulted in long term capital gain of $287,500.00 to the partnership of George & Wrather Drilling Company, and petitioners' distributable share of such capital gain is $145,179.29.

[fol. 386] Wherefore, the petitioners pray that the Court may hear the proceeding and:

1. Determine that the Commissioner erred in treating the gain from the sale of oil payments as ordinary income in the taxable year ended December 31, 1948, as set forth in the notice of deficiency, thereby increasing petitioners' share of the ordinary income of the partnership and decreasing their share of long term capital gain;

[fol. 387] 3. Grant such other and further relief as the Court may deem proper.

Allen E. Pye, Attorney for Petitioners, P. O. Box 629, Tyler, Texas.

ATTACHMENT TO AMENDED PETITION

U. S. Treasury Department

Office of Internal Revenue Agent in Charge, Mercantile Commerce Building, Dallas 1, Texas

October 9, 1951.

DALLAS
IRA: 90D:D

Mr. John Wrather and
Mrs. Nell Wrather,
Husband and Wife
512 Southwest Reserve Life Building
Longview, Texas

DEAR MR. and MRS. WRATHER:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948 and 1949, discloses deficiencies of $122,715.34 and $72,404.66, respectively, as shown in the statement attached. [fol. 388] In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 2nd Floor, Mercantile Commerce Building, Dallas 1, Texas, for the attention of C:RLP. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days

after the filing of the form, or on the date assessment is made, whichever is earlier.

Very truly yours, John B. Dunlap, Commissioner, By /s/ E. A. Peavy, Internal Revenue Agent in Charge.

Enclosures: Statement, Form of Waiver.

[fol. 389] DALLAS
IRA 90:90D:D

Statement

Mr. John Wrather, and Mrs. Nell Wrather, Husband and Wife, 512 Southwest Reserve Life Bldg., Longview, Texas

Income Tax Liability for the Taxable Years Ended December 31, 1948 and 1949

Year	Deficiency
1948	$112,715.84
1949	72,404.66
Total	$185,120.00

In making this determination of your income tax liability careful consideration has been given to the report of examination dated April 17, 1951.

[fol. 390] Taxable Year Ended December 31, 1948

Adjustments To Net Income

Net income as disclosed by joint return		$106,422.06
Unallowable deductions and additional income:		
(a) Excessive depletion	$2,565.23	
(b) Excessive depreciation	3,981.53	
(c) Bad debts	111,805.76	
(d) Loss on abandoned leases	3,875.27	
(e) Partnership income—George & Wrather Drilling Company, Mt. Carmel, Illinois	104,218.75	
Total	$226,446.54	
Nontaxable income and additional deductions:		
(f) Capital gains decreased	$70,736.03	
(g) Capital loss	1,000.00	
(h) Partnership income decreased—George & Wrather Drilling Company, Longview, Texas	1,754.00	
(i) O-80-Grape Bottling Company	7,302.67	
Total	$80,792.70	
[fol. 391]		
Net addition		145,653.84
Your net income adjusted		$252,075.90

Explanation of Changes

(a) Depletion is allowed in the amount of $129,952.33, instead of $132,517.56, and the difference, $2,565.23, is disallowed.

(b) Depreciation on well and lease equipment was found allowable in the amount of $11,426.78. Since $15,407.81 was claimed in the return, the excess, or $3,981.03, is disallowed.

(c) Advances to three O-SO-Grape Bottling Companies totalling $111,805.76 were deducted as bad debts by you, but are held to be additional cost of your investment and are to be so considered upon disposition of your interests in these companies. See Exhibits A and B.

The amounts to the three companies were as follows:

O-SO-Grape Bottling Company, Houston, Texas	$ 49,267.86
O-SO-Grape Bottling Company, San Antonio, Texas	45,782.47
O-SO-Grape Bottling Company, Longview, Texas	16,755.43
Total	111,805.76

[fol. 392] (d) The cost of the Wilson lease, $3,875.27, is disallowed as a loss in 1948. The leasehold cost should have been recovered through depletion during the production period.

(e) and (f) Partnership income from George and Wrather Drilling Company, Mount Carmel, Illinois has been adjusted to include your share of proceeds from sale of oil payments as ordinary income, (e), $104,218.75 and since you reported capital gain, and Exhibit A shows a net loss, the whole amount of capital gain reported is eliminated in (f), $79,736.03 per return. See item (g) below for allowance of loss.

(g) See Exhibit A for computation of the loss, and the carry-over to 1949. Amount allowed for 1948, $1,000.00.

(h) This adjustment is to eliminate the short-term capital gain from George & Wrather Drilling Company, Longview, Texas, which is used in Exhibit A to compute the net loss carry-over, amount $1,754.00.

(i) Your share of the operating loss of O-SO-Grape

Bottling Company, Longview, Texas, was not claimed in the return and is allowed here in the amount of $7,302.67.

[fol. 393] Taxable Year Ended December 31, 1948

Computation of Income Tax

Net income as corrected	$252,075 90
Less: Exemption (2 x $600.00)	1,200 00
Income subject to tentative tax	$250,875 90
One-half of such income for joint return	$125,437 95
Tentative tax	$89,959 78 (1)
Tax Reduction: $68 00 plus 12% of $89,559.78	$10,815 17 (2)
Normal tax and surtax (1) minus (2)	$79,144 61
Multiply amount of combined tax by 2 for joint return—Income tax liability	$158,289 22
Income tax liability disclosed by return, Account No. 3196319	45,573 88
Deficiency in income tax	$112,715 34

[fol. 394] Taxable Year Ended December 31, 1949

Adjustments To Net Income

Net income as disclosed by joint return		$100,917 16
Unallowable deductions and additional income:		
(a) Excessive depletion	$957 33	
(b) Excessive depreciation	2,443 48	
(c) Other losses claimed	109,230 67	
Total	$112,631 48	
Additional deductions:		
(d) Dependents' earnings	$738 25	
(e) Contributions	7,811 89	
(f) Income from sale of assets	1,362 13	
(g) Capital loss	1,000 00	
Total	$10,912 27	
Net addition		$101,719 21
Net income adjusted		$202,636 37

Explanation of Adjustments

(a) Depletion is allowed in the amount of $117,013.70, instead of $117,971.08, as claimed and the difference of $957.33 disallowed.

[fol. 395] (b) Depreciation on well and lease equipment is allowed in the amount of $13,415.16, instead of $15,858.64, as claimed and the excessive amount, $2,443.48, disallowed.

(c) Advances and expenditures totalling $109,230.67 for the O-SO-Grape Company of San Antonio, Texas, claimed

as an ordinary loss is held to be a long-term capital loss. See Exhibit B for inclusion in cost of this amount and the bad debt disallowed in 1948 ($45,782.47) for advances to this company.

(d) Your dependents' earnings are not taxable to you and are, therefore, eliminated here.

(e) Income adjustments above have increased your adjusted gross income so that 15% thereof exceeds the total contributions and the full amount is deductible.

Contributions allowed	$25,620.80
Amount deducted	17,808.91
Additional amount allowed	7,811.89

(f) Income from the sale of bottling equipment and other assets, $1,362.13, is eliminated here since it is shown in Exhibit B, capital gains.

(g) The amount of the net capital loss allowable in this year is deducted here, $1,000.00. See Exhibit B.

[fol. 396] Taxable Year Ended December 31, 1949

Computation of Income Tax

Net income as corrected		$202,636 37
Less: Exemption (4 x $600.00)		2,400 00
Income subject to tentative tax		$200,236 37
One-half of such income for joint return		$100,118 19
Tentative tax		$67,425 19 (1)
Tax Reduction: $68 00 plus 12% of $67,025.19		$8,111 02 (2)
Normal tax and surtax (1) minus (2)		$59,314 17
Multiply amount of combined tax by 2 for joint return—Income tax liability		$118,628 34
Income tax liability disclosed by return, Account No. BB/C 209		46,223 68
Deficiency in income tax		$72,404 66

[fol. 397]

EXHIBIT A

Sale of Assets—1948

Asset	Unrecovered Cost	Sales Price	Gain (Loss)	Taken Into Account
Morris Lease Equipment	$1,603.60	$7,362.31	$5,758.71	$2,879.36
Alexander Lease Equipment	1,033.37	930.00	(103.37)	(51.69)
Miscellaneous Equipment	195.66	227.50	31.84	15.92
1947 Dodge Auto	1,500.54	1,225.00	(275.54)	(137.77)
1941 Chrysler Auto	—0—	500.00	500.00	250.00
Navion Plan-	6,802.50	6,550.00	(252.50)	(126.25)
Beechcraft Plane	9,445.00	9,145.00	(300.00)	(150.00)
Wheeler Boat	14,488.00	13,500.00	(988.00)	(494.00)
McLin Lease	1,432.06	1,500.00	67.94	33.97
Partnership Interest— 2/3 O-SO-Grape Bottling Co., Longview, Texas (1)	36,417.08	20,000.00	(16,417.08)	(8,208.54)
Individual Totals	$72,917.81	$60,939.81	($11,978.00)	($5,989.00)

[fol. 398]

Less: Short-term capital gain, George & Wrather Drilling Co., Longview, Texas	1,754.00	
Basis in plane and boat considered to be personal:		
Navion Plane, 10% of $126.25	12.63	
Wheeler Boat, 50% of $494.00	247.00	
Long-term gain, George & Wrather Drilling Co., Mt. Carmel, Ill.	1,429.29	3,442.92
Capital Loss for 1948		$2,546.08
Amount deductible 1948		1,000.00
Capital loss carry-over to 1949		$1,546.08

[fol. 399]

(1) Basis of Partnership Interest:		
Purchase of 2/3 interest at 11-25-47 (note given)		$19,000.00
Cash advances from 11-25-47 to 9-24-48		16,839.43
Assumption of liability O-SO-Grape Co., Houston, Texas		3,587.17
Assumption of liability O-SO-Grape Co., San Antonio, Texas		2,532.65
Payment of Lon Miller note 11-25-47		2,038.50
Total credits to capital		$43,988.75
Cash received in payment of accounts receivable due from O-SO-Grape Co., San Antonio, Texas	$269.00	
Operating loss from 11-25-47 to 9-24-48	7,302.67	
Total debits		7,571.67
Capital balance at date of sale		$36,417.08

[fol. 400]

Exhibit B

Capital Gains and Losses

Year Ended December 31, 1949

	Cost	Value or Sales Price	Gain (Loss)
Loss on liquidating dividend from O-SO-Grape Co., San Antonio, Texas	$195,013.14	$ 0,000.00	($155,013.14)
Sale of miscellaneous assets (long-term)			657.06
Long-term loss			$154,356.08
Amount taken into account			($77,178.04) x 2
Net capital loss carry-over from 1948 (Exhibit A)			($1,546.08)
Sale of bottling equipment (short-term)	20,000.00	20,705.07	705.07
Net capital loss for year 1949			($78,019.05)
Amount deductible for 1949			1,000.00
Net capital loss carry-over to 1950			($77,019.05)

[fol. 401]

Note:

Cost of stock of O-SO-Grape Company, San Antonio, Texas, is computed as follows:

Total capital paid in at date of incorporation, August, 1947	$1,000.00
Cash spent on behalf of the corporation from period January 27, 1947, to December 31, 1947	$126,260.25
Cash spent on behalf of the corporation for period January 1, 1948, to December 31, 1948	27,852.67
Advances from January 1, 1949, to September 22, 1949	40,900.22
Total	$196,013.14
Less: Refund to John Wrather in 1949, representing original cost of capital stock	1,000.00
Cost of stock at liquidation date	$195,013.14

The value placed on the assets is the same amount bid by Wrather in the foreclosure sale as follows:

Equipment	$20,000.00
Real estate and building	$20,000.00
Value in liquidation	$40,000.00

[fol. 402] IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

ANSWER TO AMENDED PETITION - Filed June 14, 1954

Comes now the Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, and for answer to the amended petition filed in this proceeding, admits and denies as follows:

1

Admits the allegations contained in paragraph 1 of the amended petition.

2

Admits the allegations contained in paragraph 2 of the amended petition.

3

Admits the allegations contained in paragraph 3 of the amended petition.

[fol. 403]

4

(a) and (b) Denies that the Commissioner erred as alleged in subparagraphs (a) and (b) of paragraph 4 of the amended petition.

5

(a) to (c) Admits the allegations contained in subparagraphs (a) to (c), inclusive, of paragraph 5 of the amended petition.

(d) Denies the allegations contained in subparagraph (d) of paragraph 5 of the amended petition.

6

(a) and (b) Admits the allegations contained in subparagraphs (a) and (b) of paragraph 6 of the amended petition.

(c) Admits in June 1947 corporate books and records were opened for the O-So-Grape Bottling Company of Houston, Texas; and denies the remainder of the allegations contained in subparagraph (c) of paragraph 6 of the amended petition.

(d) to (f) Denies the allegations contained in subparagraphs (d) to (f), inclusive, of paragraph 6 of the amended petition.

(g) Admits the allegations contained in subparagraph [fol. 404] (g) of paragraph 6 of the amended petition.

(h) Denies the allegations contained in subparagraph (h) of paragraph 6 of the amended petition.

7

(a) and (b) Admits the allegations contained in subparagraphs (a) and (b) of paragraph 7 of the amended petition.

(c) Admits in June 1947 corporate books and records were opened for the O-So Grape Bottling Company of San Antonio, Texas; and denies the remainder of the allegations contained in subparagraph (c) of paragraph 7 of the amended petition.

(d) to (f) Denies the allegations contained in subparagraphs (d) to (f), inclusive, of paragraph 7 of the amended petition.

(g) Admits the allegations contained in subparagraph (g) of paragraph 7 of the amended petition.

(h) and (i) Denies the allegations contained in subparagraphs (h) and (i) of paragraph 7 of the amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinabove expressly admitted, qualified or denied.

[fol. 405] Wherefore, it is prayed that the determination of the Commissioner of Internal Revenue be approved.

(Signed) Daniel A. Taylor, JMK; Daniel A. Taylor, Chief Counsel, Internal Revenue Service.

Of Counsel: James L. Backstrom, Regional Counsel, John P. Higgins, Special Attorney, Internal Revenue Service.

JHP cjp 6 8 54

[fol. 406] In The Tax Court of The United States

[Title omitted]

Official Report of Proceedings Dated June 14, 1954
Filed July 27, 1954

* * * * * * *

Q. Now, do you recall how long you remained a member of that partnership, Mr. Wrather?

A. I don't recall the exact date we dissolved that, but they then entered into another partnership, and if I may explain, it happened this way: This George & Wrather Drilling Company, production company that I have told you about, was operating in Illinois, Indiana and Kentucky, and at the same time I was operating personally in East Texas, and everywhere else in Texas. I was also operating personally with Mr. Walters and Mr. Penn in what I have just told you, Wrather, Penn & Walters. It so happened that the war was over, the pipe loosened up—what I mean, you could get materials and also you could drill on smaller pieces of acreage. Now, during the time that the right to drill on small acreage was, I'd say stopped, on account of Federal regulations, I had acquired quite a few [fol. 407] leases in the East Texas Field. Some of those I acquired in my name, and some in the name of George & Wrather Production Company, with a view to drill them if, as, and when the regulations were lifted where we could drill them. Now, what happened, just as I had anticipated—we had quite a few wells to drill. We had drilling rigs in Illinois, so we sent two of those drilling rigs down to East Texas and drilled our own wells and several other wells we had found under certain contracts, and we brought Mr. Wimberly down at that time to look after them.

Q. George & Wrather?

A. George & Wrather Drilling Company.

* * * * * * *

Q. There was some talk about this partnership, George & Wrather and you and Mr. George and Mr. Wimberly were operating primarily up in the Illinois and Indiana fields?

A. It started primarily up there, but then later on we did operate in Texas, and as far as that goes, we operated in Wyoming and Oklahoma.

Q. What kind of work did George & Wrather do, primarily, drilling or producing?

A. Both drilling and producing. Most of the time they would sell interests in the leases and probably retain an eighth in it, or a quarter, and in some cases a half, and drill the wells, and then, of course, if we got oil, well, why then, we developed it.

* * * * * * *

[fol. 408] IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

STIPULATION OF FACTS—Filed June 14, 1954

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above entitled taxpayers, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy.

1

At all times pertinent to this proceeding, the Petitioners, John and Nell Wrather, were husband and wife, and resided in Longview, Texas.

[fol. 409] 2

On or about March 15, 1949, the Petitioners, John Wrather and wife, Nell Wrather, filed a joint income tax return for the calendar year 1948. The said return is attached hereto and marked Exhibit A-1.

3

On or about March 15, 1950, the Petitioners, John Wrather and his wife, Nell Wrather, filed a joint income tax return

for the calendar year 1949. The said return is attached hereto and marked Exhibit B 2.

4

At all times pertinent to this proceeding, the Petitioner, John Wrather, was a partner with T. W. George and F. B. Wimberly in a partnership doing business as George & Wrather Drilling Company, with its principal place of business located at Mt. Carmel, Illinois. The partnership return of George & Wrather Drilling Company is attached hereto and marked Exhibit C 3.

5

By conveyances dated July 29, 1946, December 23, 1946, and July 1, 1947, T. W. George, John Wrather, and F. B. Wimberly, as co-partners doing business as George & Wrather Drilling Company, received from T. W. George and wife, Edmee May George, an assignment of oil and gas leases on a tract of land known as the Brown Lease. Copies of said assignments are attached hereto and marked Ex- [fol. 410] hibits D 4, E 5, and F 6. Proceeds of the sale of production from the Brown Lease were first received by George & Wrather Drilling Company in June, 1947.

6

By conveyance dated June 19, 1948, T. W. George, Edmee May George, F. B. Wimberly, Virginia Wimberly, John Wrather, and Nell Wrather, individually, and doing business as George & Wrather Drilling Company, sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment in the amount of $130,000.00, to be paid out of 9/10 of 7/24 of 7/8 of all the oil produced and saved from the Brown Lease. A copy of said oil payment assignment is attached hereto and marked Exhibit G 7.

7

In consideration of the assignment of the oil payment interest in the Brown Lease, the Indiana Farm Bureau Cooperative Association, Inc., paid to the George & Wrather Drilling Company the sum of $125,000.00 cash, on or about the date of the assignment.

8

By conveyance dated November 24, 1947, T. W. George, John Wrather, and F. B. Wimberly, as co-partners doing business as George & Wrather Drilling Company, received an assignment of oil and gas leases known as the Kieffer "A" Lease. A copy of said assignment is attached hereto and marked Exhibit H-8. Proceeds of the sale of produc-
[fol. 411] tion from the Kieffer "A" Lease were first received by the George & Wrather Drilling Company in November, 1947.

9

By conveyance dated June 19, 1948, T. W. George, Edmee May George, John Wrather, Nell Wrather, F. B. Wimberly and Virginia Wimberly, individually, and doing business as George & Wrather Drilling Company, sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment in the amount of $155,000.00, to be paid out of 9/10 of 5/16 of 7/8 of all the oil produced and saved from the Kieffer "A" Lease. A copy of said oil payment assignment is attached hereto and marked Exhibit I-9.

10

By conveyance dated August 16, 1948, T. W. George, Edmee May George, John Wrather, Nell Wrather, F. B. Wimberly, and Virginia Wimberly, individually, and doing business as George & Wrather Drilling Company, sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., an oil payment of $12,500.00, to be paid out of 9/10 of 5/16 of 7/8 of all the oil produced and saved from the Kieffer "A" Lease. A copy of said oil payment assignment is attached hereto and marked Exhibit J-10.

11

In consideration of the assignments of the oil payment interest out of the Kieffer "A" Lease as set forth in Paragraphs 9 and 10 above, the Indiana Farm Bureau Cooperative Association, Inc., paid George & Wrather Drilling
[fol. 412] Company the sum of $162,500.00 cash, on or about the dates of the assignments.

12

In June, 1948, the Indiana Farm Bureau Cooperative Association, Inc., first received proceeds from the sales of production attributable to its oil payment interests in the Kieffer "A" and Brown Leases.

13

By June, 1952, the Indiana Farm Bureau Cooperative Association, Inc., had received $130,000.00 as proceeds attributable to its oil payment interest in the Brown Lease.

14

By November, 1953, the Indiana Farm Bureau Cooperative Association, Inc., had received $167,500.00 as proceeds attributable to its oil payment interest in the Kieffer "A" Lease.

15

At the time that the George & Wrather Drilling Company conveyed to Indiana Farm Bureau Cooperative Association, Inc., the oil payment interests out of the Kieffer "A" and Brown Leases, it could be reasonably calculated that said oil payments would pay out in approximately four to six years.

[fol. 413]

16

At all times pertinent hereto, the George & Wrather Drilling Company held the Kieffer "A" and Brown Leases for the development and production of oil, gas, and other minerals therefrom.

(Signed) Daniel A. Taylor, ATA; Daniel A. Taylor, Chief Counsel, Internal Revenue Service; Allen E. Pye, Attorney for Petitioners.

[fol. 414] IN THE TAX COURT OF THE UNITED STATES

Docket No. 38267

JOHN WRATHER and NELL WRATHER, Husband and Wife, Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

T. C. Memo. 1955-104

Allen E. Pye, Esq., for the petitioners.
John P. Higgins, Esq., for the respondent.

Memorandum Findings of Fact and Opinion—Filed April 26, 1955

JOHNSON, *Judge:* Respondent determined deficiencies in petitioners' income tax for 1948 and 1949 in the amounts of $112,715.34 and $72,404.66, respectively. The following issues are presented in this proceeding:

(1) Was petitioners' gain from the sale of an oil payment in 1948 ordinary income or capital gain?

(2) Were petitioners entitled to certain claimed bad debt deductions for 1948 and 1949?

(Seal.)

[fol. 415] FINDINGS OF FACT

Some of the facts are stipulated and are incorporated herein by this reference.

John and Nell Wrather, husband and wife, were residents of Longview, Texas. They filed joint tax returns for 1948 and 1949 with the collector of internal revenue for the second district of Texas. John Wrather will hereinafter be referred to as the petitioner.

Issue I

Facts.—During 1948 and 1949 petitioner, T. W. George, and F. B. Wimberly were partners in a business known as George & Wrather Drilling Company, hereinafter referred to as the partnership.

In 1948, petitioner, George and Wimberly, as partners, held certain oil and gas lease assignments for tracts of land known as the Brown Lease and the Kieffer "A" Lease. Both leases were productive and had produced income for the partnership prior to 1948. By a conveyance dated June 19, 1948, the partners and their wives, as individuals and for the partnership, sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc., hereinafter referred to as the Cooperative, an oil payment in the amount of $130,000 to be paid out of 9/10ths of 7/24ths of 7/8ths of the oil produced and saved from the Brown Lease. In consideration for this oil payment assignment the Cooperative paid the partnership $125,000 in cash on or about the date of the assignment.

[fol. 416] By another conveyance dated June 19, 1948, the partners and their wives, as individuals and for the partnership, sold and conveyed to the Cooperative an oil payment in the amount of $155,000, to be paid out of 9/10ths of 5/16ths of 7/8ths of all the oil produced and saved from the Kieffer "A" Lease.

On August 16, 1948, the partners and their wives conveyed to the Cooperative another $12,500 oil payment out of the Kieffer "A" Lease. In consideration for these oil payments from the Kieffer "A" Lease, the Cooperative paid the partnership $162,500 cash on or about the date of the assignments.

In June 1948 the Cooperative received its first proceeds attributable to the oil payments from both leases. By January 1952, the Cooperative had received $130,000 from the Brown Lease and by June 1953, $167,500 from the Kieffer "A" Lease. The reasonable pay-out time on the three interests was calculated at the time of the assignments to be from four to six years.

Opinion.—In this first issue the questions of fact have been stipulated and the remaining question of law is whether petitioner's share of the gain from the sale of an oil payment is a capital gain or ordinary income. Petitioner reported the gain as capital gain but respondent determined it to be ordinary income.

The decision in this case is controlled by the decisions in prior cases involving the sale and exchange of oil payments. [fol. 417] In *Ortiz Oil Co.*, 37 B.T.A. 656, affd. 102 F. 2d

508, it was held that the grantor of an oil payment realized a taxable gain on the sale of an oil payment. The gain was based on the considerations received for the oil payment, but the court did not discuss the question of whether the gain was capital gain or ordinary income.

In a later case, *John David Hawn*, 23 T.C. 516, the Court was required to decide whether the consideration received by Hawn in exchange for an oil payment constituted capital gain or ordinary income. The Court, following *Lester et al. Nordan*, 22 T.C. 1132, held that Hawn's conveyance of an oil payment was a transfer of a capital asset, and the gain realized therefrom was taxable as capital gain.

Similarly, it was held by the Court of Appeals, Fifth Circuit, in *Caldwell* v. *Campbell*, 218 F. 2d 567, where a taxpayer transferred oil payments in exchange for cash and notes, that the oil payments were capital assets. The gain was then held to be taxable as capital gain.

Since the *Hawn*, *Nordan* and *Caldwell* cases have established that oil payments should be treated as capital assets, and since we are unable to distinguish the oil payments in the present case from those in the *Hawn*, *Nordan* and *Caldwell* cases, we must find that the oil payments conveyed by petitioner to the Cooperative were capital assets. Further, since there is no dispute that the properties were held for more than six months, petitioner's gain is taxable as capital gain under section 117 of the 1939 Code.

[fol. 418] In The Tax Court of The United States

[Title omitted]

Decision—Entered August 18, 1955

Pursuant to Memorandum Findings of Fact and Opinion of the Tax Court filed April 26, 1955, petitioners filed a computation on July 22, 1955, and on August 2, 1955, respondent filed a computation. On August 8, 1955, respondent filed an objection to petitioner's computation, and on August 17, 1955, a hearing was had thereon, at which both parties appeared. After due consideration of the computations of both parties and respondent's objection to petitioners' computation, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1948 and 1949 in the respective amounts of $37,962.81 and $72,404.66.

Luther A. Johnson, Judge.

Served August 19, 1955

[fol. 419] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 420] Exhibit D-4

Miscellaneous Gas and Oil Lease Record No. 28

Assignment of Oil and Gas Leases

Know All Men By These Presents: That the undersigned, T. W. George and Edmee May George, his wife, hereinafter called Assignors, for and in consideration of One Dollar ($1.00) to them in hand paid, the receipt and sufficiency whereof is hereby acknowledged, do hereby sell, assign, transfer and set over unto T. W. George, John Wrather and E. B. Wimberly, co-partners doing business as George Wrather Drilling Company, hereinafter called assignees, an undivided one twelfth (1/12) working interest in and to the following described oil and gas leases, to wit:

1. Oil and gas lease dated May 8, 1946, from Fred Horn and Garnett Horn, his wife, lessors, to Olen D. Sharp, lessee, recorded in Book 27, of Oil and Gas Leases at page 12 in the office of the Recorder of Wabash County, Illinois, which lease covers the following described real estate, to-wit:

All of the East Half ($E\frac{1}{2}$) of the Southeast Quarter ($SE\frac{1}{4}$) of Section 35, lying North of the Southern Railroad; and all of the West Half ($W\frac{1}{2}$) of the Southwest Quarter ($SW\frac{1}{4}$) of Section 36 lying North of the Southern Railroad; the tract in Section 35 containing 33 acres, and the tract in Section 36 containing 31 acres; situate in the County of Wabash in the State of Illinois, in Township 1 South, Range 14 West;

2. Oil and gas lease dated June 3, 1946, from Martha Brown, a widow, lessor, to Olen D. Sharp, lessee, recorded in Book 27 of Oil and Gas Leases at page 17 in the office of said Recorder, which lease covers the following described real estate, to wit:

> The North Half ($N\frac{1}{2}$) of the Southwest Quarter ($SW\frac{1}{4}$) and the South Half ($S\frac{1}{2}$) of the Northwest Quarter ($NW\frac{1}{4}$); all in Section 1, Township 2 South, Range 14 West, containing in all 160 acres, more or less, situate in the County of Wabash, in the State of Illinois;

3. Oil and gas lease dated May 8, 1946, from Charles Joachim and Maude Joachim, his wife, Lessors, to Olen D. Sharp, lessee, recorded in Book 27 of Oil and Gas Leases at page 18 in the office of said Recorder, which lease covers the following described real estate, to wit:

> The Northwest Quarter ($NW\frac{1}{4}$) of the Northeast Quarter ($NE\frac{1}{4}$) of Section Thirty-six (36); the Southeast Quarter ($SE\frac{1}{4}$) of the Northwest Quarter ($NW\frac{1}{4}$) of Section 36; and the East 18 acres of the Southwest quarter ($SW\frac{1}{4}$) of the Northwest Quarter ($NW\frac{1}{4}$) of Section 36; all in Township 1 South, Range 14 West, situate in the County of Wabash, in the State of Illinois;

4. Oil and gas lease dated May 10, 1946, from Harry Epler and Norma Epler, his wife, lessors, to Olen D. Sharp, lessee, recorded in Book 27, at page 15 in the office of said Recorder, which lease covers the following described real estate, to-wit:

> The Southeast Quarter ($SE\frac{1}{4}$) of the Northeast Quarter ($NE\frac{1}{4}$), excepting therefrom one (1) acre out of the Southeast corner, being Methodist Church property and Gilkison property, and excepting also filling station property described as follows: Commencing 434.5 feet North and 30 feet West of the Southeast Corner of the Northeast Quarter ($NE\frac{1}{4}$) of Section 36, Township 1 South, Range 14 West, for beginning; thence West 211 feet; thence North 43 degrees East along the Southerly right-of-way line of the State

Highway 340.5 feet; thence South along the West line of the right of way 223.5 feet to place of beginning, containing .54 of an acre, situate in the County of Wabash in the State of Illinois;

5. Oil and gas lease dated May 10, 1946, from Cyrus K. Gilkison and Garnett M. Gilkison his wife; Omar C. Gilkison and Ferrid D. Gilkison, his wife; Christina E. Wiseman and Bryan B. Wiseman, her husband; Violet McClain and Charles McClain, her husband; Maurice Yohe and Katherine Yohe, his wife; William C. Niblo and Teletha B. Niblo, his wife; Rudolph F. Niblo and Anna Niblo, his wife; and Thelma Niblo, a single person, lessors, to Olen D. Sharp, lessee, which lease is recorded in Book 27 at page 8 in the office of said Recorder and covers the following described real estate, to-wit:

The Northwest Quarter (NW^1_4) of the Southeast Quarter (SE^1_4) of Section 36, Township 1 South, Range 14 West, containing 40 acres, more or less.

The East Half (E^1_2) of the Southwest Quarter (SW^1_4) of the Northeast Quarter (NE^1_4) of Section 36, Township 1 South, Range 14 West, except a strip one-third ($^1_3$) of a rod wide off the East side of said tract, the tract containing 20.54 acres;

All that fraction of land lying South of the Southern Railway right of way in the Northwest Quarter (NW^1_4) of the Southwest Quarter (SW^1_4) of Section 36, Township 1 South, Range 14 West, containing 7 acres, more or less.

The Southeast quarter (SE^1_4) of the Southwest Quarter (SW^1_4) of Section 36, Township 1 South, Range 14 West, containing 40 acres, more or less;

The Northeast Quarter (NE^1_4) of the Southwest Quarter (SW^1_4) of Section 36, Township 1 South, Range 14 West, containing 40 acres, more or less;

The Southwest Quarter (SW^1_4) of the Southwest Quarter (SW^1_4) of Section 36, in Township 1 South, Range 14 West, containing 40 acres, more or less;

All that portion of land lying North of the Southern Railway right of way exclusive of Lots in the West Half (W^1_2) of the Northeast Quarter (NE^1_4) of the Southeast Quarter (SE^1_4) of Section 36, Township 1

South, Range 14 West, West of the Town of Bellmont, Illinois, containing 5 acres, more or less;

All situate in the County of Wabash in the State of Illinois.

[fol. 421] 6. Oil and gas lease dated May 8, 1946, from Thomas J. Brines and Hattie F. Brines, his wife, lessors, to Olen Sharp, lessee, recorded in Book 27, of Oil and Gas Leases, at page 11 in the office of said Recorder, which lease covers the following described real estate, to wit:

The West Thirteen (13) acres of the Southwest Quarter (SW^1_4) of the Northwest Quarter (NW^1_4) of Section 36; and the Southeast Quarter (SE^1_4) of the Northeast Quarter (NE^1_4) of Section 35; all in Township 1 South, Range 14 West, Wabash County, Illinois, and containing in all 53 acres, more or less.

7. Oil and gas lease dated April 26, 1945, from Blanche Ehrenberg and Theodore Ehrenberg, her husband, and Milton Taylor, her son, a single man, lessors, to Olen D. Sharp, lessee, recorded in Book 24 of Oil and Gas Leases at page 552 in the office of said Recorder, which lease covers the following described real estate, to wit:

The East ten (10) acres of the West half (W^1_2) of the Southwest Quarter (SW^1_4) of the Northeast Quarter (NE^1_4) of Section 36, Township 1 South, Range 14 West, situate in the County of Wabash, in the State of Illinois;

8. Oil and gas lease dated May 8, 1946, from Bryan Garrett and Viola Garrett, his wife; Mildred Garrett, a widow; H. Leo Garrett and Rachel Garrett, his wife; Irvin Garrett and Ruth Garrett, his wife; and Howard E. Garrett, a single man; lessors, to Olen D. Sharp, lessee, recorded in Book 27 at page 13 in the office of said Recorder, which lease covers the following described real estate, to wit:

The North half (N^1_2) of the Northwest Quarter (NW^1_4) of Section One (1), Township 2 South, Range 14 West, and the Northeast Quarter (NE^1_4) of the Northeast Quarter (NE^1_4) of Section 2, Township 2 South, Range 14 West, containing 120 acres, more or less; also all that part of the West Half, (W^1_2) of the

Southeast Quarter (SE^1_4) of Section 35, lying South of the Southern Railroad, in Township 1 South, Range 14 West, containing 38 acres, more or less; situate in the County of Wabash in the State of Illinois.

Together with all the rights incident thereto and the personal property thereon, appurtenant thereto, or used or obtained in connection therewith.

And for the same consideration the assignors covenant with the Assignees, their heirs, and assigns: That the assignors are the lawful owners of and have good title to the interest above assigned in and to said leases, estates, rights and property, free and clear from all liens, encumbrances or adverse claims; that said leases are valid and subsisting leases on the lands above described, and all rentals and royalties due thereunder have been paid and all conditions necessary to keep the same in force have been duly performed; and Assignors hereby surrender and release all rights of dower and homestead in the premises above described, insofar as same may in any way affect the purposes hereof.

Executed this 29th day of July, 1946.

T. W. George, (Seal). Edmee May George, (Seal).

STATE OF ILLINOIS,
County of Wabash, ss:

I, J. K. Cline, a Notary Public, in and for said County in the State aforesaid, do hereby certify that T. W. George and Edmee May George, his wife, personally known to me to be the same persons whose names are subscribed to the foregoing instrument, appeared before me this day in person and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act, for the uses and purposes therein set forth, including the release and waiver of the right of homestead.

Given under my hand and Seal, this 29th day of July, A. D. 1946.

J. K. Cline, Notary Public. (Notarial Seal).

Filed for record this the 6th day of November, A. D. 1946, at 9:55 o'clock A. M.

R. E. Friend, Recorder.

[fol. 422] EXHIBIT E 5

Miscellaneous Gas and Oil Record No. 30

Assignment of Interest in Oil and Gas Leases

Know all men by these presents, That the undersigned, T. W. George and Edince May George, his wife, hereinafter called Assignors, for and in consideration of One Dollar ($1.00) to them in hand paid, the receipt and sufficiency whereof is hereby acknowledged, do hereby sell, assign, transfer and set over unto T. W. George, John Wrather, F. B. Wimberly, co-partners doing business as George & Wrather Drilling Company, hereinafter called assignee, an undivided Two twenty-fourths (2/24) working interest in and to the following described oil and gas leases, to-wit:

1. Oil and gas lease dated May 8, 1946, from Fred Horn and Garnett Horn, his wife, lessors, to Olen D. Sharp, lessee, recorded in Book 27, of Oil and Gas Leases at page 12, in the office of the Recorder of Wabash County, Illinois, which lease covers the following described real estate, to-wit:

> All of the East Half ($E\frac{1}{2}$) of the Southeast Quarter ($SE\frac{1}{4}$) of Section Thirty-five (35), lying North of the Southern Railroad; and all of the West Half ($W\frac{1}{2}$) of the Southwest quarter ($SW\frac{1}{4}$) of Section Thirty-six (36) lying North of the Southern Railroad; the tract in Section 35 containing 33 acres, and the tract in Section 36 containing 31 acres; situate in the County of Wabash in the State of Illinois, in Township 1 South, Range 14 West.

2. Oil and gas lease dated June 3, 1946, from Martha Brown, a widow, lessor, to Olen D. Sharp, lessee, recorded in Book 27, of Oil and Gas Leases at page 17 in the office of said Recorder, which lease covers the following described real estate, to-wit:

> The North half ($N\frac{1}{2}$) of the Southwest Quarter ($SW\frac{1}{4}$) and the South Half ($S\frac{1}{2}$) of the Northwest Quarter ($NW\frac{1}{4}$) all in Section One (1), Township Two (2) South, Range Fourteen (14) West, containing in all 160 acres, more or less, situate in the County of Wabash in the State of Illinois;

3. Oil and gas lease dated May 8, 1946, from Charles Joachim and Maude Joachim, his wife, lessors, to Olen D. Sharp, lessee, recorded in Book 27 of Oil and Gas Leases at page 18 in the office of said Recorder, which lease covers the following described real estate, to wit:

> The Northwest Quarter (NW^1_4) of the Northeast Quarter (NE^1_4) of Section Thirty-six (36); the South, east quarter (SE^1_4) of the Northwest quarter (NW^1_4) of Section Thirty-six (36); and the East Eighteen (18) acres of the Southwest quarter (SW^1_4) of the Northwest Quarter (NW^1_4) of Section Thirty-six (36); all in Township One (1) South, Range Fourteen (14) West, situate in the County of Wabash in the State of Illinois.

[fol. 423] 4. Oil and gas lease dated May 10, 1946, from Harry Epler and Norma Epler, his wife, lessors, to Olen D. Sharp, lessee; recorded in Book 27 at page 15 in the office of said Recorder, which lease covers the following described real estate, to wit:

> The Southeast Quarter (SE^1_4) of the Northeast quarter (NE^1_4), excepting therefrom one (1) acre out of the Southeast corner, being Methodist Church property and Gilkison property, and excepting also filling Station property described as follows: Commencing 434.5 feet North and 30 feet West of the Southeast corner of the Northeast quarter (NE^1_4) of Section 36, Township 1 South, Range 14 West, for beginning; thence West 211 feet; thence North 43 degrees East along the Southerly right-of-way line of the State highway 310.5 feet; thence South along the West line of the right-of-way 223.5 feet to place of beginning, containing .54 of an acre, situate in the County of Wabash in the State of Illinois.

5. Oil and gas lease dated May 8, 1946, from Thomas J. Brines and Hattie F. Brines, his wife, lessors, to Olen D. Sharp, lessee, recorded in Book 27, of Oil and Gas Leases at page 11 in the office of said Recorder, which lease covers the following described real estate, to wit:

> The West Thirteen (13) acres of the Southwest quarter (SW^1_4) of the Northwest Quarter (NW^1_4)

of Section 36; and the Southeast Quarter (SE^1_4) of the Northeast Quarter (NE^1_4) of Section 35, all in Township 1 South, Range 14 West, Wabash County, Illinois, and containing in all 53 acres, more or less.

6. Oil and gas lease dated April 26, 1945, from Blanche Ehrenberg and Theodore Ehrenberg, her husband; and Milton Taylor, her son, a single man, lessors, to Olen D. Sharp, lessee, recorded in Book 24 of Oil and Gas Leases at page 552, in the office of said Recorder, which lease covers the following described real estate, to wit:

The East Ten (10) acres of the West Half (W^1_2) of the Southwest quarter (SW^1_4) of the Northeast quarter (NE^1_4) of Section Thirty six (36), Township 1 South, Range 14 West, situate in the County of Wabash in the State of Illinois.

7. Oil and gas lease dated May 8, 1946, from Bryan Garrett, and Viola Garrett his wife; Mildred Garrett, a widow; H. Leo Garrett, and Rachel Garrett, his wife; Irvin Garrett, and Ruth Garrett, his wife, and Howard E. Garrett, a single man, lessors, to Olen D. Sharp, lessee, recorded in Book 27, at page 13, in the office of said Recorder, which lease covers the following described real estate, to-wit:

The West Half (W^1_2) of the Southwest Quarter (SW^1_4) of the Northeast quarted (NE^1_4) of Section Thirty six (36), Township One (1) South, Range Fourteen West, containing 20 acres, more or less, situate in the County of Wabash in the State of Illinois;

8. Oil and gas lease dated May 8, 1946, from C. F. Brian, a widower; Blanche T. Runcie, a widow; and Pearl T. Kirsch and E. C. Kirsch, her husband, lessors, to Olen D. Sharp, lessee, recorded in Book 27, at page 21, in the office of said Recorder, which lease covers the following described real estate, to-wit:

The North half (N^1_2) of the Northwest Quarter (NW^1_4) of Section One (1), and the Northeast Quarter (NE^1_4) of the Northeast Quarter (NE^1_4) of the Northeast Quarter (NE^1_4) of Section Two (2), in Township 2 South, Range 14 West, containing 129

acres, more or less; also all that part of the West half (W½) of the Southeast Quarter (SE¼) of Section 35 lying South of the Southern Railroad, in Township 1 South, Range 14 West, containing 38 acres, more or less, situate in the County of Wabash, in the State of Illinois;

Together with all the rights incident thereto, and the personal property thereon, appurtenant thereto, or used or obtained in connection therewith.

The interest hereby assigned is made subject to and burdened with a one-half part of overriding royalty interest heretofore assigned by the assignor aggregating the 1/64 part of the 7/8 part of all oil and gas or either to be produced, saved and marketed from said lands under the terms of said leases, free and clear of all cost to the holders of such aggregate interest. This assignment is not subject to such overriding royalty interest, and such overriding royalty interest shall be borne by and burdened upon the Working Interest remaining in the name of the Assignor.

And for the same consideration the assignors covenant with the assignee, his heirs and assigns; That the assignors are the lawful owners of and have good title to the interest above assigned in and to said leases, estates, rights and property, free and clear from all liens, encumbrances, or adverse claims; that said leases are valid and subsisting leases on the lands above described, and all rentals and royalties due thereunder have been paid and all conditions necessary to keep the same in force have been duly performed; and assignors hereby surrender and release all rights of dower and homestead in the premises above described.

Executed this 23rd day of December, 1946.

T. W. George, (Seal). Edmee May George, (Seal).

State of Illinois,
County of Wabash, ss:

I, J. K. Cline, a Notary Public, in and for said County in the State aforesaid, do hereby certify that T. W. George and Edmee May George, his wife, personally known to me to be the same persons whose names are subscribed to the

foregoing instrument, appeared before me this day in person, and acknowledged that they signed, sealed and [fol. 424] delivered said instrument as their free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right of homestead.

Given under my hand and Seal, this 23rd day of December, 1946.

J. K. Cline, Notary Public. (Notarial Seal)

Filed for record this the 2nd day of June, A. D. 1947, at 9:15 o'clock A. M.

R. E. Friend, Recorder.

[fol. 425] Exhibit F-6

Miscellaneous Gas and Oil Record No. 30

Assignment of Oil and Gas Lease

Know all men by these presents: That the undersigned T. W. George and Edmee May George, his wife, (hereinafter called Assignor), for and in consideration of One Dollar ($1.00) the receipt whereof is hereby acknowledged, does hereby sell, assign, transfer and set over unto T. W. George, John Wrather and F. B. Wimberly, DBA, George & Wrather Drilling Co. (hereinafter called Assignee), an undivided one-eighth (1/8) interest in and to the oil and gas lease dated June 3, 1946, from Martha Brown, a widow, Lessor, to Olen D. Sharp, Lessee, recorded in book 27, page 17, insofar as said lease covers the following described land in Wabash County, State of Illinois.

The North Half ($N^1/_2$) of the Southwest Quarter ($SW^1/_4$) and the South Half ($S^1/_2$) of the Northwest Quarter ($NW^1/_4$), all in Section One (1), Township Two (2) South, Range Fourteen (14) West, containing in all 160 acres, more or less.

This assigned interest is subject to and burdened with the one-half proportionate part of an overriding royalty interest heretofore reserved by Olen D. Sharp, entitling him to receive one-thirty-second (1/32) of seven-eights

(7/8) of all oil and gas hereinafter produced, saved and marketed from the above described lands under the terms of said lease, free and clear of all costs, together with the rights incident thereto and the personal property thereon, appurtenant thereto, or used or obtained in connection therewith.

And for the same consideration the Assignor covenants with the Assignee, its or his heirs, successors or assigns: That the Assignor is the lawful owner of and has good title to the interest above assigned in and to said lease, estate, rights and property, free and clear from all liens, encumbrances or adverse claims; That said lease is a valid and subsisting lease on the land above described, and all rentals and royalties due thereunder have been paid and all conditions necessary to keep the same in full force have been duly performed; and that the Assignor will warrant and forever defend the same against all persons whomsoever, lawfully claiming or to claim the same, and hereby surrenders and releases all rights of dower and homestead in the premises above described.

Executed, This 1st day of July, 1947.

T. W. George, (Seal), Edmee May George, (Seal).

State of Illinois,
County of Wabash, ss:

I, J. K. Cline, a Notary Public in and for the said County in the State aforesaid, Do Hereby Certify, That T. W. George and Edmee May George, his wife, personally known to me to be the same persons whose names are subscribed to the foregoing instrument, appeared before me this day in person, and acknowledged that they signed, sealed and delivered the said Instrument, including the release and waiver of the right of homestead, as their free and voluntary act, for the uses and purposes therein set forth.

Given under my hand and Notarial Seal; this 1st day of July, A. D., 1947. (Seal)

My Commission expires 10-21-1947.

J. K. Cline, Notary Public. (Notarial Seal)

Filed for Record the 21st day of August, A. D. 1947, at 8:50 o'clock A. M.

R. E. Friend, Recorder.

[fol. 426] Exhibit G-7

Oil Payment Agreement

Know All Men By These Presents:

That the undersigned

T. W. George, Edmee May George, John Wrather, Nell Wrather, Fred B. Wimberly and Virginia Wimberly, individually and doing business as "George & Wrather Drilling Company."

(hereinafter sometimes referred to as "George & Wrather"), for and in consideration of Ten Dollars ($10.00) and other valuable consideration, the receipt of which is hereby acknowledged, hereby agree and direct that

Indiana Farm Bureau Cooperative Association, Inc.

(hereinafter sometimes referred to as "COOP"), shall be paid the sum of One Hundred and Thirty Thousand Dollars ($130,000.00) the said sum to be paid out of the oil produced and saved from the lands hereinafter described, and to be 9/40 of 7/24 of 7/8 of all the oil produced and saved therefrom, until the full sum of One Hundred and Thirty Thousand Dollars ($130,000.00) shall have been paid to COOP.

The said payments shall be made out of the oil produced and saved from the following described real estate:

> The North half of the Southwest Quarter, and the South half of the Northwest Quarter, all lying in Section one (1), Township two (2) South, Range Fourteen (14) West, and containing 160 acres, more or less, Wabash County, Illinois.

which real estate is covered by the following described oil and gas leases:

> That certain Oil and Gas leases, executed by Martha D. Brown, widow, as Lessor to Olen D. Sharp, as Lessee, under date of June 3, 1946, the same being

recorded in Oil and Gas Lease Record 27, page 17 et seq. in the office of the Recorder of Wabash County, Illinois.

George & Wrather hereby direct that the aforesaid payments shall be paid directly to COOP by the purchaser of such oil, and COOP is hereby authorized to execute Division Orders necessary to effect such payment. This agreement, and payments made in accordance therewith, shall be effective as of June 1, 1948.

It is hereby stipulated and agreed that George & Wrather, and the individual partners thereof, shall have no personal liability by reason of this oil payment agreement. It is further stipulated and agreed that the said oil payment is secured by no other interest or lien other than as set out in this Agreement.

For the aforesaid consideration, George & Wrather covenent with COOP: That George & Wrather are the lawful owners of, and have good title to the interests out of which said oil is to be produced, free and clear from all liens, encumbrances or adverse claims, save and except those which may now or heretofore exist in favor of COOP; that the leases under which said oil is to be produced are valid and subsisting oil and gas leases on the lands herein described, and that all rentals and royalties due thereunder have been paid, and all conditions necessary to keep the same in full force have been duly performed.

George & Wrather hereby surrender and release all rights of dower and homestead insofar as they may effect the oil payment hereby created.

This Agreement shall be binding upon the heirs, successors and assigns of the undersigned.

[fol. 427] In witness whereof, we have set our hands and seals this 19th day of June, 1946. (8)

Edmee May George, (Seal), Nell Wrather, (Seal), Virginia Wimberly, (Seal), T. W. George, (Seal), John Wrather, (Seal), Fred B. Wimberly, (Seal).

individually and operating and doing business as George & Wrather Drilling Company (Seal)

By T. W. George, John Wrather, Fred B. Wimberly.

STATE OF TEXAS,
County of Gregg, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George and Edmee May George, his wife; John Wrather and Nell Wrather, his wife; Fred B. Wimberly and Virginia Wimberly, his wife, personally known to me appeared before me this day and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act and deed for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this 19th day of June, 1946.

J. H. Walters, Notary Public.

My commission expires June 1, 1949.

STATE OF TEXAS,
County of Gregg, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George, John Wrather and Fred B. Wimberly, operating and doing business as George & Wrather Drilling Company personally known to me to be the same persons whose names are subscribed to the foregoing instruments, appeared before me this day in person, and acknowledged that they signed, sealed and delivered the said instruments as their free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this 19th day of June, 1948.

J. H. Walters, Notary Public.

My commission expires June 1, 1949.

[fol. 428] EXHIBIT H

9442

Assignment of Oil and Gas Lease

Whereas heretofore, under date of October 16, 1947, Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as Lessors, did execute and deliver to William E. Brubeck, as Lessee, an Oil and Gas Lease covering the following described lands situated in Gibson County, Indiana, to wit:

The West one-half ($\frac{1}{2}$) of the Southwest Quarter ($SW\frac{1}{4}$) of Section 25, Township 1 South, Range 12 West, containing 80 acres, more or less; said lease being recorded in Vol. 67 at page 349, of the records of said County;

And whereas heretofore, under date of October 16, 1947, Helen Postelnek, a widow, J. B. Whisenant and Mabel Whisenant, his wife, John W. Russell and Leona Russell, his wife, and Harry F. Corbin, Jr., and Sara Hyde Corbin, his wife, as Lessors, did execute and deliver to William E. Brubeck an Oil and Gas Lease covering the same premises above described, said lease being recorded in Vol. 67 at page 347, of the Records of Gibson County, Indiana;

And whereas heretofore under date of October 16, 1947, Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as Lessors, did execute and deliver to William E. Brubeck, as Lessee, an Oil and Gas Lease covering the following described lands situated in Gibson County, Indiana, to wit:

All that part of the Southwest Quarter ($SW\frac{1}{4}$) of the Northwest Quarter ($NW\frac{1}{4}$) of Section 25, Township 1 South, Range 12 West, lying south of the Patoka River, containing 16 acres, more or less; said lease being recorded in Vol. 67 at page 351, of the records of said County;

Now, therefore, know all men by these presents, that the undersigned, William E. Brubeck and Ann Denton Brubeck, his wife, hereinafter called the Assignors, for and in consideration of Ten Dollars ($10.00) and other good and valuable considerations, the receipt whereof are hereby acknowledged, do hereby sell, assign, transfer and set over unto T. W. George, John Wrather and F. B. Wimberly, Partners, doing business as George & Wrather Drilling Company of Mt. Carmel, Illinois, hereinafter called Assignee, subject to the overriding royalty interest here-

inafter mentioned, an undivided five-sixteenths (5/16) interest in and to the three Oil and Gas Leases above described, together with the rights incident thereto.

This assignment is expressly made subject to an overriding royalty of one thirty second (1/32) of the leasehold seven eights (7/8) of all oil and gas produced and saved from said premises, the same having been created by an assignment from the Assignors herein to Ben H. Townsend and Joel W. Townsend dated November 24, 1947.

This assignment shall be effective as of November 1, 1947.

The terms hereof shall extend to and be binding upon the parties hereto, their heirs, legal representatives, successors and assigns; and the Assignors do hereby surrender and release all rights of dower and homestead in the premises above described.

In Witness Whereof we have hereunto set our hands and seals this 24th day of November, 1947.

William E. Brubeck (Seal), Ann Denton Brubeck (Seal).

STATE OF ILLINOIS,
County of Wabash, ss:

I, B. J. Walter, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that William E. Brubeck and Ann Denton Brubeck, his wife, personally known to me to be the same persons whose names are subscribed to the foregoing instrument, appeared before me this day in person and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right to homestead.

Given under my hand and Seal, this 24th day of November, 1947.

B. J. Walter, Notary Public. (N. P. Seal)

My commission expires Feb. 7, 1951.

Recorded December 1, 1947 at 2:00 P. M.,

Chas. W. Maxum, RGC

CERTIFICATE

STATE OF INDIANA,
County of Gibson, ss:

I, Charles L. Mans, Recorder of the County of Gibson, State of Indiana, do hereby certify that the foregoing is a true, correct and complete copy of the instrument as the same appears of record in my office in Book 68, Page 201.

Charles L. Mans, Recorder of Gibson County, Indiana.

[fol. 429] EXHIBIT I-9

Oil Payment Agreement

Know All Men By These Presents:

That the undersigned

T. W. George, Edmee May George, John Wrather, Nell Wrather, Fred B. Wimberly and Virginia Wimberly, individually and doing business as "George & Wrather Drilling Company",

(hereinafter sometimes referred to as "George & Wrather"), for and in consideration of Ten dollars ($10.00) and other valuable consideration, the receipt of which is hereby acknowledged, hereby agree and direct that

Indiana Farm Bureau Cooperative Association, Inc. (hereinafter sometimes referred to as "COOP") shall be paid the sum of One hundred and fifty-five thousand dollars ($155,000) the said sum to be paid out of the oil produced and saved from the lands hereinafter described, and to be 9/10 of 5/16 of 7/8 of all the oil produced and saved therefrom, until the full sum of One hundred and fifty-five thousand dollars ($155,000) shall have been paid to COOP.

The said payments shall be made out of the oil produced and saved from the following described real estate:

The Southwest Quarter ($SW^1/_4$) of Section twenty-five (25) Township one (1) South, Range twelve (12) West containing One Hundred Sixty (160) acres, more or less Gibson County, Indiana.

which real estate is covered by the following described oil and gas leases:

That Oil and Gas lease entered into between Helen Postelnak, widow, et al, as lessors, and William E. Brubeck, as lessee, dated October 16, 1947, and recorded in Lease Record Book 67, page 347, in the records of Gibson County, Indiana, and
that Oil and Gas lease entered into between Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as lessors, and William E. Brubeck, as lessee, dated October 16, 1947, and recorded in Book 67, page 349, in the records of Gibson County, Indiana.
that Oil and Gas lease entered into between Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as lessors, and William E. Brubeck, as lessee, dated December 23, 1947, and recorded in Book 67, page 561, in the records of Gibson County, Indiana, and
that Oil and Gas Lease entered into between Helen Postelnak, as lessor, and William E. Brubeck, as lessee, dated December 23, 1947, and recorded in Book 67, Page 471 in the records of Gibson County, and
that Oil and Gas Lease entered into between John W. Russell, et al, as lessors, and William E. Brubeck, lessee, dated December 29, 1947, and recorded in Book 67, Page 513, in the records of Gibson County, Indiana.

George & Wrather hereby direct that the aforesaid payments shall be paid directly to COOP by the purchaser of such oil, and COOP is hereby authorized to execute Division Orders necessary to effect such payment. This agreement, and payments made in accordance therewith, shall be effective as of June 1, 1948.

It is hereby stipulated and agreed that George & Wrather, and the individual partners thereof, shall have no personal liability by reason of this oil payment agreement. It is [fol. 430] further stipulated and agreed that the said oil payment is secured by no other interest or lien other than as set out in this Agreement.

For the aforesaid consideration, George & Wrather covenant with COOP: That George & Wrather are the lawful owners of, and have good title to the interests out of which said oil is to be produced, free and clear from all liens,

encumbrances or adverse claims, save and except those which may now or theretofore exist in favor of COOP; that the leases under which said oil is to be produced are valid and subsisting oil and gas leases on the lands herein described, and that all rentals and royalties due thereunder have been paid, and all conditions necessary to keep the same in full force have been duly performed.

George & Wrather hereby surrender and release all rights of dower and homestead insofar as they may effect the oil payment hereby created.

This Agreement shall be binding upon the heirs, successors and assigns of the undersigned.

In Witness Whereof, we have set our hands and seals this 19th day of June, 1948.

Edmee May George (Seal), Nell Wrather (Seal), Virginia Wimberly (Seal), T. W. George (Seal), John Wrather (Seal), Fred B. Wimberly (Seal).

Individually and operating and doing business as George & Wrather Drilling Company (Seal).

By T. W. George, John Wrather, Fred B. Wimberly.

STATE OF TEXAS,
County of Gregg, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George and Edmee May George, his wife; John Wrather and Nell Wrather, his wife; Fred B. Wimberly and Virginia Wimberly, his wife, personally known to me appeared before me this day and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act and deed for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this 19 day of June, 1948.

J. H. Walters, Notary Public.

My commission expires June 1, 1949.

[fol. 431] STATE OF TEXAS,
County of Gregg, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George, and John Wrather and Fred B. Wimberly, operating and doing business as George & Wrather Drilling Company personally known to me to be the same persons whose names are subscribed to the foregoing instruments, appeared before me this day in person, and acknowledged that they signed, sealed and delivered the said instruments as their free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this 19 day of June, 1948.

J. H. Walters, Notary Public.

My commission expires June 1, 1949.

[fol. 432] EXHIBIT J-10

Oil Payment Agreement

Know all men by these presents:

That the undersigned

T. W. George, Edmee May George, John Wrather, Nell Wrather, Fred B. Wimberly and Virginia Wimberly, individually and doing business as "George & Wrather Drilling Company."

(hereinafter sometimes referred to as "George & Wrather"), for and in consideration of Ten Dollars ($10.00) and other valuable consideration, the receipt of which is hereby acknowledged, hereby agree and direct that

Indiana Farm Bureau Cooperative Association, Inc.
(hereinafter referred to sometimes as "COOP")

shall be paid the sum of Twelve Thousand Five Hundred Dollars ($12,500.00), the said sum to be paid out of the oil produced and saved from the lands hereinafter described, and to be 9/10 of 5/16 of 7/8 of all the oil produced and

saved therefrom, until the full sum of Twelve Thousand Five Hundred Dollars ($12,500.00) shall have been paid to COOP.

The said payments shall be made out of the oil produced and saved from the following described real estate:

> The Southwest Quarter (SW^1_4) of the Section twenty five (25), Township one (1) South, Range twelve (12) West, containing One Hundred Sixty (160) acres, more or less, Gibson County, Indiana

which real estate is covered by the following described Oil and Gas Leases:

> That Oil and Gas Lease entered into between Helen Postelnak, widow, et al, as Lessors, and William E. Brubeck, as leasee, dated October 16, 1947, and recorded in Lease Record Book 67, page 347, in the records of Gibson County, Indiana, and
>
> that Oil and Gas Lease entered into between Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as lessors, and William K. Brubeck, as lessee, dated October 16, 1947, and recorded in Book 67, page 349, in the records of Gibson County, Indiana, and
>
> that Oil and Gas lease entered into between Lawrence J. Kieffer and Anna Belle Kieffer, his wife, as lessors, and William E. Brubeck, as lessee, dated December 23, 1947, and recorded in Book 67, page 561, in the records of Gibson County, Indiana, and
>
> that Oil and Gas Lease entered into between Helen Postelnak, as lessor, and William E. Brubeck as lessee, dated December 23, 1947, and recorded in Book 67, page 471, in the records of Gibson County, Indiana, and
>
> that Oil and Gas lease entered into between John W. Russell (et al, as lessors, and William E. Brubeck, as lessee, dated December 29 1947, and recorded in Book 67, page 513, in the records of Gibson County, Indiana.

George & Wrather hereby direct that the aforesaid payments shall be paid directly to COOP by the purchaser of such oil, and COOP is hereby authorized to executed Divi-

sion Orders necessary to effect such payment." This agreement, and payments made in accordance therewith, shall be effective as of August 1, 1948.

It is hereby stipulated and agreed that George & Wrather, and the individual partners thereof, shall have no [fol. 433] personal liability by reason of this oil payment agreement. It is further stipulated that the said oil payment is secured by no other interest or lien other than as set out in this agreement.

For the aforesaid consideration, George & Wrather covenant with COOP: That George and Wrather are the lawful owners of, and have good title to the interests out of which said oil is to be produced, free and clear from all liens, encumbrances or adverse claims, save and except those which may now or heretofore exist in favor of COOP; that the leases under which said oil is to be produced are valid and subsisting oil and gas leases on the lands herein described, and that all rentals and royalties due thereunder have been paid, and all conditions necessary to keep the same in full force have been duly performed.

George & Wrather hereby surrender and release all rights of dower and homestead in so far as they may effect the oil payment hereby created.

This Agreement shall be binding upon the heirs, successors and assigns of the undersigned.

In Witness Whereof, we have set our hands and seals this 16th day of August, 1948.

Edmee May George (Seal), Nell Grather (Seal), Virginia Wimberly (Seal), T. W. George (Seal), John Wrather (Seal), Fred B. Wimberly (Seal).

Individually and operating and doing business as George & Wrather Drilling Company (Seal).

By T. W. George.

STATE OF,

County of, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George and Edmee May George, his wife; John Wrather and Nell Wrather, his wife; Fred B. Wimberly and Virginia Wimberly, his wife, personally known to me appeared

before me this day and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act and deed for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this day of August, 1948.

Notary Public.

My commission expires:

[fol. 434] State of,
County of, ss:

I, the undersigned, a Notary Public, in and for said County, in the State aforesaid, do hereby certify that T. W. George, John Wrather and Fred B. Wimberly, operating and doing business as George & Wrather Drilling Company, personally known to me to be the same persons whose names are subscribed to the foregoing instrument, appeared before me this day in person, and acknowledged that they signed, sealed and delivered the said instrument as their free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right of homestead and dower.

Given under my hand and seal this day of August, 1948.

Notary Public.

My commission expires:

[fol. 435] Minute Entry of Argument and Submission—December 3, 1956

(Omitted in Printing)

[fol. 436] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 16055

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

versus

JOHN WRATHER AND NELL WRATHER, Husband and Wife, Respondents.

Petition for Review of Decision of the Tax Court of the United States (District of Texas).

OPINION—February 1, 1957

Before Hutcheson, Chief Judge, and Holmes and Borah, Circuit Judges.

HUTCHESON, *Chief Judge:* This appeal from an unreported decision of the Tax Court on stipulated facts,[1]

[1] Briefly and adequately stated, they are:

In 1948 the George & Wrather Drilling Company, a Partnership, of which the taxpayer, John Wrather, was a member, sold and conveyed to the Indiana Farm Bureau Cooperative Association, Inc. (herein called COOP) three oil payments carved out of their interests in two oil and gas leases which had been held by the partnership for more than six months. One was for $130,000, payable out of 9/10 of 7/24 of 7/8 of all of the oil produced and saved from the Brown Lease; the others were for $155,000 and $12,500, respectively, payable out of 9/10 of 5/16 of 7/8 of all of the oil produced and saved from the Kieffer "A" Lease.

As consideration for these assignments, COOP paid the partnership $287,500 cash which was treated by the partners on their tax returns as gain from the sale of capital assets. The oil payment out of the Brown Lease paid out in a period of 4 years and the oil payments out of the Kieffer "A" Lease paid out in a period of 5 years 5 months.

[fol. 437] and findings by the Tax Court in favor of respondents, presents the single question whether the Tax Court erred in holding that taxpayer John Wrather's share of the proceeds received from the sale by a partnership, of which he was a member, of oil payments carved out of leasehold estates owned and operated by it was long term capital gain under Sec. 117, rather than ordinary income subject to depletion.

Here the Commissioner advances the same contentions and arguments which, at greater length, he advanced in *Commissioner* v. *Lake and Fleming* & *Commissioner*, this day decided, while the respondents here oppose to them substantially the same contentions and arguments advanced by the respondents in those cases.

Referring to, without restating the considerations upon, and the reasons for, which, rejecting the commissioner's, and sustaining the taxpayer's, contentions, we conclude that those cases had been correctly decided below, it is sufficient for us to hold that, upon those same considerations and for the same reasons, we conclude that this [fol. 438] case was correctly decided and that the decision and order appealed from should be Affirmed.

[fol. 439] In the United States Court of Appeals for the Fifth Circuit

No. 16055

Commissioner of Internal Revenue,

versus

John Wrather and Nell Wrather, Husband and Wife

Judgment—February 1, 1957

This cause came on to be heard on the petition of Commissioner of Internal Revenue for a review of a decision of The Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision and

order of the said Tax Court appealed from in this cause be, and the same is hereby, affirmed.

[fol. 440] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 441] [Caption omitted.]

[fol. 442] IN THE TAX COURT OF THE UNITED STATES

Docket No. 46312

W. F. WEED, Individual and Estate of Eleanor M. Weed, Deceased—W. F. Weed, Executor, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

APPEARANCES

For Petitioner: Peter B. Wells, Esq.
For Respondent: W. B. Riley, Esq.

DOCKET ENTRIES

1953

Jan. 8—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 8—Copy of petition served on General Counsel.

Feb. 25—Answer filed by General Counsel.

Feb. 25—Request for hearing in Houston, Texas filed by General Counsel.

Mar. 3—Notice issued placing proceeding on Houston, Texas calendar. Service of answer and request made.

[fol. 443] 1954

Jan. 15—Hearing set April 5, 1954, Galveston, Texas.

Mar. 29—Motion for continuance filed by taxpayer. 3-31-54 Granted.

Jul. 20—Hearing set October 25, 1954, Houston, Texas.

1954

Nov. 1—Hearing had before Judge Black, on merits, petitioner's oral motion to amend petition, denied, oral motion of petitioner to take deposition of J. P. LaFour, granted. Entry of appearance of Peter B. Wells, filed. Petitioner's brief due January 3, 1955. Respondent's brief due February 3, 1955. Petitioner's reply brief due March 1, 1955.

Dec. 28—Transcript of hearing 11 1 54 filed.

Dec. 30—Motion for extension to February 14, 1955 to file petitioner's brief March 16, 1955 to file answering brief, and April 15, 1955 to file reply brief filed by taxpayer 12 30 54 Granted.

1955

Feb. 14—Motion for extension to February 18, 1955 to file brief and to March 21, 1955 to file respondent's answering brief filed by taxpayer. 2 15 55 Granted.

Feb. 17—Brief filed by taxpayer. 2 18 55 Copy served.

Mar. 15—Motion for extension to May 5, 1955 to file answering brief filed by General Counsel. 3 16 55 Granted.

Apr. 18—Motion for extension to June 13, 1955 to file answering brief filed by General Counsel. 4 19 55 Granted.

Jun. 13—Motion for extension to June 29, 1955 to file answering brief filed by General Counsel. 6 14 55 Granted.

[fol. 444] Jun. 29—Motion for extension to July 13, 1955 to file brief filed by General Counsel. 7 1 55 Granted.

Jul. 8—Answer brief filed by General Counsel. Served 7 11 55.

Aug. 16—Motion for extension to August 31, 1955 to file reply brief filed by taxpayer. 8 16 55 Granted.

Aug. 29—Motion for extension to September 16, 1955 to file reply brief filed by taxpayer. 8 29 55 Granted.

Sept. 15—Reply brief filed by taxpayer. Copy served.

Sept. 22—Findings of fact and opinion filed, Black, Judge. Decision will be entered under Rule 50. Copy served.

Dec. 13—Agreed computation filed.

Dec. 14—Decision entered, Judge, Black.

1956

Mar. 6—Petition for review by United States Court of Appeals, Fifth Circuit, with assignments of error filed by respondent.

Mar. 20—Proof of service of petition for review filed. (W. F. Weed).

Mar. 20—Proof of service of petition for review filed. (Peter B. Wells, Esq.)

Mar. 20—Proof of service of petition for review filed. (Estate of Eleanor M. Weed, Deceased, W. F. Weed, Executor).

Apr. 20—Motion for extension of time to 7 5 56 to prepare, transmit and dvliver the record on review filed by respondent.

Apr. 26—Order extending time to 7 5 56 to prepare, transmit and deliver the record on review, entered.

[fol. 445] May 7—Certified copy of order of Court of Appeals, Fifth Circuit, directing the original exhibits and original official report of proceedings at Houston, Texas, on November 1, 1954, be made part of the transcript of record filed.

May 9—Agreed praecipe for record filed.

In The Tax Court of the United States

Docket No. 46312

W. F. Weed, Individual and Estate of Eleanor M. Weed, Deceased—W. F. Weed, Executor, Petitioners,

versus

Commissioner of Internal Revenue, Respondent.

Petition—Filed and received January 8, 1953

Prepared by Taxpayer: W. F. Weed, P. O. Box 2390, Beaumont, Texas.

[fol. 446] The petitioners, W. F. Weed, individually and W. F. Weed as Executor for the Estate of Eleanor M. Weed (Deceased) hereby petition for a redetermination of

the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, Bureau symbols IRA: 90D-H, dated October 24, 1952, and as a basis of the proceeding allege as follows:

1. The petitioners were husband and wife, residing in Beaumont, Jefferson County, Texas during the entire calendar years 1948 and 1949. The wife dies on August 3, 1952 and the husband qualified as Executor for her estate (see Exhibit B attached) on October 22, 1952, being case number 13489 of the Probate Court, Jefferson County, Texas. The mailing address is P. O. Box 2390, Beaumont, Texas. The petitioners filed joint income tax returns for the calendar years 1948 and 1949 with the Collector of Internal Revenue, Austin, Texas.

[fol. 447] 2. The notice of deficiency, a copy of which is attached and marked "Exhibit A", was mailed to the petitioners on or after October 24, 1952.

3. According to the notice of deficiency, the Commissioner has determined an income tax deficiency against the petitioners for the calendar year 1948 in the amount of $4,136.79. Approximately $3,871.78 of this deficiency is in dispute in this proceeding, and approximately $265.01 of the deficiency is not contested. The Commissioner has also determined a deficiency for the calendar year 1949 in the amount of $1,055.76, all of which is in dispute.

4. Assignment of Error

The determinations set forth in the notice of deficiency are based upon the following errors:

I. The commissioner erred in disallowing long term capital gains treatment on the sale of sulphur in place in the ground.

5. Statement of Facts

The facts upon which the petitioners rely as the basis of this proceeding are as follows:

(1) The husband acquired on or before December 31, 1945, certain royalty interests in sulphur at Boling Dome, Wharton County, Texas, the extraction of which is covered by lease with the Texas Gulf Sulphur Company.

[fol. 448] (2) The installment sale in dispute was made on December 24, 1947. A copy of this sale is attached and has been marked "Exhibit C".

(3) An interest in sulphur in place in the ground comes within the scope of Section 117 of the Internal Revenue Code as being a capital asset.

(4) Since the sale in dispute was a capital asset under Section 117 of the Internal Revenue Code, and was owned for more than six months, the gain or loss on the sale thereof is covered by Section 117(b) of the Internal Revenue Code.

(5) The Commissioner's disallowance of Section 117 treatment on this sale as evidenced by an Internal Revenue Agent's report dated October 3, 1951, was based on *GCM 24849* (C. B. 1946-1, 66) and *IT 4003* (C. B. 1950-1, 10). Both GCM 24849 and IT 4003 refer specifically to oil and gas and neither refers in any way to any other minerals; therefore, the application of these two rulings must be restricted to oil and gas transactions only.

Wherefore, petitioners pray that this court hear this proceeding; disallow the deficiencies complained of, and issue an order of redetermination correctly determining pe-[fol. 449] titioners income tax liability for the calendar years 1948 and 1949.

W. F. Weed, Individual, W. F. Weed, Executor for the Estate of Eleanor M. Weed, P. O. Box 2390, Beaumont, Texas.

Duly sworn to by W. F. Weed, jurat omitted in printing.

[fol. 450] EXHIBIT A TO PETITION

DALLAS
IRA:90D-H

Statement

Mr. W. F. Weed, and Mrs. Eleanor M. Weed, Husband and Wife

P. O. Box 2390, Beaumont, Texas

Income Tax Liability for the Taxable Years Ended December 31, 1948 and 1949

Year	Deficiency
1948	$ 4,136.79
1949	1,055.76
Total	$ 5,192.55

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 23, 1951; to your protest executed October 31, 1951; and to the statements made at the conference held on December 13, 1951 and July 22, 1952.

It is held that the consideration received by you for the assignment of a sulphur payment to Marion F. Munro is ordinary income subject to the depletion allowance. The amount of $16,300.00 received by you in each of the years 1948 and 1949, therefore, has been included in ordinary in-[fol. 451] come and 23% thereof, or $3,749.00, has been allowed as depletion in each of those years, and the amounts of $7,845.56 and $7,845.55 reported by you as capital gains upon the transaction in the respective years 1948 and 1949 have been eliminated from your taxable income.

A copy of this letter and statement has been mailed to your representative, Mr. Marion F. Munro, 1020 Goodhue Building, Beaumont, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Taxable Year Ended December 31, 1948

Adjustments to Net Income

Net income as disclosed by joint return		$51,680 30
Unallowable deductions and additional income:		
(a) Disallowed as nontaxable capital gain	$1,242 52	
(b) Income from sulphur royalty	12,551 00	
(c) Net loss not deductible in 1948	2,372 01	
Total	$16,165 53	
[fol. 452]		
Additional deductions:		
(d) Capital gain decreased	$7,845 56	
(e) Casualty loss increased	633 56	
(f) Depletion on patents	73 53	
(g) Contributions	25 00	
Total	$8,577 65	
Net addition		7,587 88
Net income adjusted		$59,268 18

Explanation of Adjustments

(a) The net long-term capital losses reported have been reduced by the amount shown as deductible loss on account of worthlessness of stock of Moor-Kelly Development Corporation, which was not proved worthless in 1948, and by the part of the loss claimed on bonds of the City of Opelousas, Louisiana, which was due to the premium paid at purchase and which should have been amortized over the life of the bonds. Adjustments are:

Loss claimed and disallowed on stock	$ 1,162.52
Amount of loss claimed due to premium on bond, 50% of $160.00	80.00
Total	$ 1,242.52

(b) As stated above the amount received for the assignment of a sulphur payment less 23% depletion is included in full in income. See item (d) for reduction of capital gain.

[fol. 453] Amount received	$ 16,300.00
Less: Depletion, 23%	3,749.00
Amount taxable	$ 12,551.00

(c) Adjustments herein to net capital gains and losses reported resulted in a net short-term capital loss of $3,372.01. Since only $1,000.00 is allowable as a deduction in 1948, the remainder of $2,372.01, is to be carried over to 1949. The amount is determined as follows:

Net short-term capital loss per return		$8,121.67
Long-term capital gains per return	$7,256.08	
Long-term capital loss disallowed (a)	1,242.52	
Long-term capital gain eliminated (d)	(7,845.56)	
Long-term capital gain eliminated (e)	(344.36)	
Net amount		308.68
Net capital loss		$7,812.99
Plus capital gains and losses from fiduciaries—$8,881.96—Amount recognized—50%		4,449.98
Net capital loss		$3,372.01
Amount allowable in 1948		1,000.00
Disallowed for 1948		$2,372.01

[fol. 454] (d) The amount of long-term capital gain reported on the sulphur payment, $7,845.56, is eliminated here since the amount taxable is included in full in item (b) above.

(e) Loss from a casualty less gain on the sale of a business car is allowed as a deduction under section 117(j)(2) of the Internal Revenue Code, as follows:

Loss due to rain damage on residence	$ 1,322.27
Gain from sale of car	688.71
Net amount deductible	$ 633.56

(f) Depletion on a patent, $73.53, was omitted from the total of depletion in the return and is, therefore, deducted here.

(g) Contributions of $25.00 made by Mrs. Weed were omitted from the return and are allowed here.

Computation of Tax

Net income as corrected	$ 59,268.18	
Less: Exemptions (4 x $600.00)	2,400.00	
Income subject to tentative tax	$ 56,868.18	
½ of $56,868.18—joint return	$ 28,434.09	
Tentative tax	$ 12,249.14	(1)
[fol. 455] Tax reduction: $68.00 plus 12% of $11,849.14	1,489.90	(2)
Combined normal tax and surtax, (1) minus (2)	$ 10,759.24	
Multiply $10,759.24 by 2 for tax liability	$ 21,518.48	
Income tax liability disclosed by return—Account No. 9128679	17,381.69	
Deficiency in income tax	$ 4,136.79	

Taxable Year Ended December 31, 1949

Adjustments to Net Income

Net income as disclosed by joint return		$33,555.27
Unallowable deductions and additional income:		
(a) Income from sulphur royalty	$12,551.00	
(b) Medical expense deduction	116.67	
Total	$12,667.67	
Nontaxable income and additional deductions:		
(c) Capital gain decreased [fol. 456]	$7,845.55	
(d) Capital loss carry-over from 1948	2,372.01	
Total	$10,217.56	
Net addition		2,450.11
Net income adjusted		$36,005.38

Explanation of Adjustments

(a) Received for assignment of a sulphur payment, as above	$ 16,300.00
Less: 23% depletion	3,749.00
Net addition to taxable income	$ 12,551.00

(b) Medical expense has been adjusted to give effect to adjustments above as follows:

Amount of medical expenses		$2,972.74
Less: 5% of adjusted gross income:		
Adjusted gross income per return	$37,139.63	
Plus (a), minus (b) and (c)	2,333.44	
Total	$39,473.07	
5% of $39,473.07		1,973.65
Deduction allowable		$999.09
Amount deducted per return		1,115.76
Excessive deduction		$116.67

[fol. 457] (c) The amount, $7,845.55, reported as taxable long-term capital gain on the sulphur payment is eliminated here because the gain is included in full in item (a) above.

(d) The capital net loss carry-over from 1948 (see adjustment (c) for 1948 above) is allowed as a deduction.

Computation of Tax

Net income as corrected	$ 36,005.38	
Less: Exemptions (4 x $600.00)	2,400.00	
Income subject to tentative tax	$ 33,605.38	
½ of $33,605.38—joint return	$ 16,802.69	
Tentative tax	$ 5,601.35	(1)
Tax reduction:		
$68.00 plus 12% $5,201.35	692.16	(2)
Combined normal tax and surtax, (1) minus (2)	$ 4,909.19	
Multiply $4,909.19 by 2 for tax liability	$ 9,818.38	
Income tax liability disclosed by return—Account No. 9079305	8,762.62	
Deficiency in income tax	$ 1,055.76	

[fol. 458] Exhibit C to Petition

The State of Texas,
County of Wharton:

Whereas, the undersigned, W. F. Weed, of Jefferson County, Texas is the owner of a pooled royalty on sulphur

produced from Boling Dome, Wharton County, Texas, by Texas Gulf Sulphur Company, amounting to $.00966133 per long ton, which royalty was acquired by W. F. Weed through deeds as follows, to wit:

[fol. 459] 1. Deed from Jas. F. Weed, et ux, to Mary Weed Fletcher, et al, dated 9-1-33, conveying pooled royalties of $.005015 and $.001469, recorded in Vol. 105, page 395, Deed Records of Wharton County, Texas one third (1/3) to W. F. Weed.

2. Deed from Jas. F. Weed, et ux, to Mary Weed Fletcher, et al, dated 8-15-35, conveying pooled royalty of $.01500, recorded in Vol. 117, page 347, Deed Records of Wharton County, Texas, one-third (1/3) to W. F. Weed.

3. Deed from Cora Louise Weed, W. F. Weed and Will E. Orgain, Independent Executors of the Estate of Jas. F. Weed, Deceased, to Cora L. Weed, et al, dated 8-1-45, conveying pooled royalty of $.04500, recorded in Vol. 180, page 21, Deed Records, Wharton County, Texas one-sixth (1/6) to W. F. Weed.

4. Deed from W. F. Weed to T. E. Moor, dated 12-28-45, conveying pooled royalty of $.00500 of record in Vol. 183, page 369, Deed Records, Wharton County, Texas.

Now, Therefore, Know All Men by These Presents, that I, W. F. Weed, in consideration of the sum of Thirteen Thousand Nine Hundred ($13,900.00) Dollars in cash in hand to me paid by Marion F. Munro, of Jefferson, County, Texas, receipt of which is hereby acknowledged, and the execution and delivery by Marion F. Munro, of two promissory notes of even date hereof, payable to W. F. Weed, [fol. 460] and each of said notes being in the sum of Sixteen Thousand Three Hundred ($16,300.00) Dollars, and due respectively one and two years after date and bearing interest after maturity at the rate of six per cent (6%) per annum, do hereby Sell, Transfer and Assign, unto the said Marion F. Munro, of Jefferson County, Texas, 86.254514% of $.00966133 per long ton pooled royalty on sulphur produced by Texas Gulf Sulphur Company at Boling Dome, Wharton County, Texas, from lands and premises described in said above named conveyances, until six million (6,000,000) long tons of sulphur have been produced and accounted for to the said Marion F. Munro

therefrom, which royalty so sold and here assigned and conveyed amounts to $.00833333 per long ton.

To Have and to Hold said percent per long ton pooled royalty on sulphur so produced, together with all and singular the rights and appurtenances thereto belonging unto the said Marion F. Munro, his heirs, administrators and assigns.

This assignment and the royalty transferred and assigned hereby on sulphur produced from Boling Dome, Wharton County, Texas, by Texas Gulf Sulphur Company to be paid to Marion F. Munro shall continue and be effective until said Marion F. Munro shall have received said royalty on six million (6,000,000) long tons of sulphur and no longer. Due to the way and manner sulphur royalties are paid, the royalty for sulphur produced in the year 1947, to and through December 31, 1947, shall be paid to W. F. Weed, and said sulphur royalties covering sulphur produced on and after January 1, 1948, shall be paid to Marion F. Munro [fol. 461] until he has received said royalty on said six million (6,000,000) long tons of sulphur.

In Witness Whereof I have hereunto set my hand for seal this 24th day of December, 1947.

(Signed) W. F. Ford.

The State of Texas,
County of Jefferson:

Before me, the undersigned authority, on this day personally appeared W. F. Weed, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this 26th day of December, A. D., 1947.

(Signed) Billy Blanton, Notary Public in and for Jefferson County, Texas.

[fol. 462] IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

ANSWER Filed February 25, 1953

Comes now the Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in this proceeding admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the notice of deficiency was mailed to the petitioners on October 24, 1952; but denies the remaining allegations contained in paragraph 2 of the petition.

3. Admits in the notice of deficiency, the Commissioner has determined an income tax deficiency against the petitioners for the calendar year 1948 in the amount of $4,136.79; that the Commissioner has also determined a deficiency for the calendar year 1949 in the amount of $1,055.76, all of which is in dispute. Denies the remaining allegations contained in paragraph 3 of the petition.

[fol. 463] 4 I. Denies that the respondent erred in the manner alleged in subparagraph I of paragraph 4 of the petition.

5. (1) Admits the allegations contained in subparagraph (1) of paragraph 5 of the petition.

(2) to (4) incl. Denies the allegations contained in subparagraphs (2) to (4), inclusive, of paragraph 5 of the petition.

(5) Admits the Commissioner's disallowance of a sale is based in part on GCM 24849 (C. B. 1946-1, 66) and IT 4003 (C. B. 1950-1, 10); but denies the remaining allegations contained in subparagraph (5) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed the determination of the Commissioner be approved.

Charles W. Davis, FSG, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: James L. Backstrom, District Counsel, Allen [fol. 464] T. Akin, Appellate Counsel, Joseph P. Crowe, Special Attorney, Bureau of Internal Revenue, 316 Federal Land Bank Building, Houston, Texas.

In The Tax Court of The United States

[Title omitted]

24 T. C. No. 116

Findings of Fact and Opinion—Filed: September 22, 1955

Held, the gain resulting from W. F. Weed's sale and transfer of a sulphur payment carved out of his pooled royalty interests in sulphur produced from deposits in place, which interests Weed had owned for several years prior to the date of sale, was taxable as long-term capital gain on the installment basis and not as ordinary income.

[fol. 465] Peter B. Wells, Esq., for the petitioners.
W. B. Riley, Esq., for the respondent.

The Commissioner has determined deficiencies in petitioners' income taxes as follows:

Year	Deficiency
1948	$ 4,136.79
1949	1,055.76

(Seal.)

The deficiency for 1948 is due to the following adjustments:

(a) Disallowed as non-taxable capital gain	$ 1,242.52
(b) Income from sulphur royalty	12,551.00
(c) Net loss not deductible in 1948	2,372.01

Adjustment (b), which is the principal adjustment, is described in the deficiency notice as follows:

> (b) As stated above the amount received for the assignment of a sulphur payment less 23% depletion is included in full in income. See item (d) for reduction of capital gain.
>
> | | |
> |---|---|
> | Amount received | $16,300.00 |
> | Less: Depletion, 23% | 3,749.00 |
> | Amount taxable | $12,551.00 |

[fol. 466] The petition assigns error only as to adjustment (b) described above. The assignment of error is as follows:

> I. The commissioner erred in disallowing long-term capital gains treatment on the sale of sulphur in place in the ground.

The deficiency for 1949 is based principally upon an adjustment of the same kind and in the same amount as adjustment (b) for 1948, and the assignment of error is the same for 1949 as for 1948. There is also an adjustment for 1949 of $116.67 for disallowance of medical expenses but counsel stated at the hearing that that will be automatically taken care of when we decide the main adjustment in the case.

Findings of Fact

W. F. Weed, sometimes hereinafter referred to as petitioner, resires in Beaumont, Texas. Eleanor M. Weed was petitioner's wife during the tax years 1948 and 1949, and at all other times pertinent hereto. She died testate on August 3, 1952, whereupon, by order of the Probate Court

(Seal.)

of Jefferson County, Texas, petitioner was appointed independent executor of her estate. He has continued as such to the date of this hearing.

Petitioner and his wife filed joint income tax returns for 1948 and 1949 with the collector of internal revenue, Austin, Texas.

[fol. 467] In 1945 and 1946, as principal stockholder, petitioner formed two companies, Pre-Fab Building Supply Corporation, and Star Lumber Company, and also formed, as a wholly owned subsidiary of the latter, Planet Lumber Corporation. In 1947, these companies were in need of funds and were not sufficiently sound financially to have adequate credit. In addition, petitioner contemplated the organization of another corporation whose capital requirements would exceed $100,000. Such corporation was actually formed in May 1948, and petitioner did supply most of its capital.

Petitioner in 1947 believed that, in 1948 and the succeeding years, he would need all (or a large part) of the credit which was available to him personally at the banks or through similar sources to obtain funds for use in the carrying on of the aforementioned business enterprises. He, therefore, desired some assurance that he would have a definite source of funds (other than banks and similar sources) for payment of his individual Federal income taxes due in those later years.

On December 23, 1947, petitioner was the owner of a pooled overriding royalty interest in sulphur produced by the Texas Gulf Sulphur Company from a tract of land referred to as Boling Dome, in Wharton County, Texas.[1] Petitioner's royalty interest entitled him to receive $.0096613 [fol. 468] per long ton of sulphur produced from Boling Dome by the aforementioned company, irrespective of what the market price for such sulphur might be. Royalty payments were made by the company monthly, based on the previous month's production. Petitioner's $.0096613 per long ton interest represented the aggregate of three pooled royalty interests, each in a lesser amount, received by petitioner (a) from his father by two *inter vivos* deeds dated

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[1] The Boling Dome tract was composed of a number of parcels of land. The owners of the royalty interests in sulphur produced from each of those individual parcels entered into a pooling agreement pursuant to which royalties from sulphur produced anywhere in Boling Dome were to be distributed pro rata among all such royalty interest holders. Thus, petitioner's interest is referred to as "pooled."

September 1, 1933 and August 15, 1935, respectively, and (b) after his father's death, from the latter's estate by independent executor's deed dated August 1, 1945. Such interest was not held by petitioner primarily for sale to customers in the ordinary course of his trade or business.

In the summer or early fall of 1947, petitioner, Frank C. Taylor (a C.P.A. then retained as accountant for petitioner's personal affairs and who prepared petitioner's 1947 return), and Marion Munro (a C.P.A. then retained by two of petitioner's corporations and who subsequently prepared petitioner's individual joint returns for 1948 and 1949) discussed the problem of petitioner's business commitments and the need for providing some sure source of funds with which to pay petitioner's individual income taxes, especially those due in January 1948. It was suggested that petitioner might sell a portion of his Boling Dome royalty interests, and Munro expressed the opinion that such a transaction would have the advantage of being taxed to petitioner at capital gain rates. Munro indicated a probable willingness to purchase a portion of that royalty interest and negotiations followed.

Petitioner and Munro discussed the amount of money petitioner would probably need in later years to pay his taxes, [fol. 469] the probable amount of sulphur still in place (which they estimated to be about 45 million tons), the anticipated annual rate of sulphur production, the annual royalty payments which would probably be received by a purchased of petitioner's interest, the probable amount of time required for pay-outs from sulphur production of different sums of money, the discount factor (such as the interest Munro would have to pay on funds borrowed by him to purchase the royalty interest) which affected Munro's profit from the transaction, and the tax savings to petitioner.

It was finally agreed that the transaction would be based upon petitioner's anticipated requirements for funds to pay taxes for the succeeding three years, and upon a four-year pay-out period from sulphur production to Munro. On this basis, it was determined that petitioner would assign to Munro a portion of his royalty interest on 6,000,000 long tons of sulphur, from which Munro would receive $50,000 within about four years, and that, in return, Munro would

pay petitioner $46,500 over a three-year period. Munro advised petitioner that the latter's tax savings resulting from the transaction would be about $4,000 to $4,500 and Munro estimated that his own profit from the transaction (after allowance for the discount factor) would approach $2,000.

On December 24, 1947, petitioner executed a deed conveying to Munro 86.254514 per cent of his pooled royalty interest of $.00966133 (i.e., $.00833333) per long ton on 6,000,000 long tons of sulphur to be produced from Boling Dome. In consideration therefor Munro gave petitioner:

[fol. 470] Check dated 12 24 47	$13,900
Promissory note due 12 24 48 (with 6% annual interest after maturity)	16,300
Promissory note due 12 24 49 (with 6% annual interest after maturity)	16,300
	$46,500

Pertinent portions of the assignment follow:

I, W. F. Weed, in consideration of [$13,900 cash and the two $16,300 notes] * * *, do hereby Sell, Transfer and Assign, unto the said Marion F. Munro, * * * 86.254514% of $.00966133 per long ton pooled royalty on sulphur produced by Texas Gulf Sulphur Company at Boling Dome, Wharton County, Texas, from lands and premises described in said above named conveyances [to petitioner from his father and his father's estate], until six million (6,000,000) long tons of sulphur have been produced and accounted for to the said Marion F. Munro therefrom, which royalty so sold and here assigned and conveyed amounts to $.00833333 per long ton.

* * * * * * *

This assignment and the royalty transferred and assigned hereby on sulphur produced from Boling Dome, * * * shall continue to be effective until said Marion F. Munro shall have received said royalty on six million (6,000,000) long tons of sulphur and no longer. * * *

[fol. 471]

The following statement shows the payments made by Munro to petitioner, pursuant to the above conveyances, and the method of financing used by Munro:

Date	Munro's payments to petitioner	Munro's loans from First National Bank, Beaumont, Texas: Amount	Annual Int.	Fully Paid By	Total Int. Paid
Dec. 24, 1947	$13,900	$13,900	4%	8/20/48	$224 41
Sept. 25, 1948	2,000				
Dec. 20, 1948	14,300	8,500	5%	5/19/49	95 14
Dec. 19, 1949		3,000	5%	2/20/50	18 19
Dec. 23, 1949	16,300				
Total	$46,500	$25,400			$337 74

[fol. 472] Munro's loans from the bank were negotiated by him independently of petitioner and were not guaranteed by petitioner. As security for the loans Munro assigned to the bank the royalty interest purchased from petitioner until such time as all his loans were paid. Concurrently with that assignment he notified the Texas Gulf Sulphur Company to make his royalty checks payable jointly to himself and the bank and to mail them directly to the bank. The bank credited the royalty checks received first to the principal and interest due on the above loans and, when that was satisfied, to Munro's personal account. Receipt of royalty checks from Texas Gulf Sulphur Company averaging about $2,000 each from February 28, 1948 until March 20, 1950 (on which date the limited royalty interest on 6,000,000 tons was fully paid out) resulted in its being unnecessary for Munro to borrow more than $11,500 in order to meet the two $16,300 notes due petitioner, since Munro was able to, in part, pay those notes at maturity with royalties received and accumulated prior thereto.

As above indicated the limited royalty interest which petitioner assigned Munro on December 24, 1947, was paid out within 28 months thereafter. In his income tax returns Munro reported the royalties he received as ordinary income, less cost depletion, in the year of receipt.

Petitioner used the $13,900 received from Munro on December 24, 1947, in paying the January 15, 1948 installment on his 1947 Federal income tax.

Separate individual Federal tax returns for 1947 were filed, on a community property basis, by petitioner and his

wife. The above transaction was fully disclosed in those [fol. 473] returns, was treated as resulting in capital gain, and the profits therefrom were reported on the installment basis. After adjustments for basis and costs of sale, the profit realized in 1947 from the $13,900 received that year was reported as $13,380.78. Fifty per cent thereof, $6,690.39, was taken into account as a community long term capital gain and petitioner and his wife each reported half of that sum ($3,345.19) as their community share in the separate returns they filed.

Petitioner and his wife filed joint income tax returns for both 1948 and 1949. In each of those years petitioner received from Munro, pursuant to the terms of the aforementioned transaction, $16,300. In their return for each year they reported, after adjusting the $16,300 for basis, a profit of $15,691.11 on the installment basis, and took 50 per cent thereof ($7,845.56) into account as long term capital gain.

OPINION

BLACK, *Judge:* Some of the adjustments made by the Commissioner in his determination of the deficiencies are not contested and these adjustments will be given effect in a recomputation under Rule 50.

The issues which we do have before us are common to both years. Petitioner states the issues in his brief as follows:

1. Whether the Commissioner erred in taxing to petitioner as ordinary income for the years 1948 and 1949 [fol. 474] proceeds from the 1947 sale of a sulphur royalty and whether such proceeds are long term capital gains and properly reported on the installment basis.

2. If it be determined that petitioner realized ordinary income from the sale of such sulphur royalty, whether all the proceeds should be reported as ordinary income for the year 1947.

The amounts which petitioner has received in each of the taxable years in return for the limited sulphur royalty (hereinafter referred to as a sulphur payment) which he conveyed to Munro in 1947, are not in dispute. Petitioner, in joint returns filed with his wife, returned the profits from those receipts in each taxable year as capital gain on

the installment basis. The Commissioner does not question use of the installment basis in returning the income for taxation nor does he question the accuracy of the amounts of the profits reported. He does question petitioner's right to use the capital gain method and has determined that the gain from conveyance of the sulphur payment is taxable as ordinary income and not as capital gain. That determination is based on the Commissioner's conclusion that the transaction in issue was an assignment of income itself rather than the conveyance of income producing property.

In support of the treatment of gains from the transaction as capital gains petitioner cites and relies upon our recent decisions in *Lester A. Nordan*, 22 T.C. 1132; *John David Hawn*, 23 T.C. 516, now on review in the Fifth Circuit; and other cases which were cited and discussed in the *Nordan* and *Hawn* cases. We think petitioner must prevail on the strength of these authorities, as well as the more recently [fol. 475] decided *Caldwell* v. *Campbell*, (C.A. 5) 218 F. 2d 567; *Wm. Fleming*, 24 T.C. ——, July 29, 1955; and *A. J. Stagter, Jr.*, 24 T.C. ——, August 25, 1955. It is true that in the aforementioned cases the mineral interests which were involved were oil payments, whereas here sulphur payments are involved. However, we think that fact makes no difference and that the same rule must be applicable to the sale and transfer of sulphur payments as applies to the sale and transfer of oil payments.[2] We so hold and, following the above decisions, we decide this issue in favor of petitioner. Since those cases adequately discussed the point of law involved it is unnecessary to here repeat the discussion.

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[2] Cases dealing with minerals other than oil and gas have played their parts in the development of the law applicable to oil and gas. See, e.g., GCM 22730, 1941-1 C.B. 214, citing *Bankers' Pocahontas Coal Co.* v. *Burnet*, 287 U. S. 308 (coal). Conversely, we think that those principles stated in oil and gas cases are applicable alike to other minerals, absent evidence of special circumstances compelling a distinction (such as substantial differences in controlling provisions of the Internal Revenue Code). As stated in GCM 22730, *supra*, at p. 219, "Like issues arise in the oil and mineral cases which are cited interchangeably in the evolution of the applicable rules."

In his brief, respondent attempts to distinguish the *Nordan*, *Hanch*, and *Caldwell* cases, all *supra*, upon the grounds that the taxpayers therein transferred their *entire* interests in oil in place, retaining only a reversionary interest therein after satisfaction of the oil payments from the interests conveyed, whereas here petitioner conveyed merely a fractional part of his interest in sulphur in place (86.2545514 per cent of his pooled royalty interest of $.00966133, that is to say $.00833333 per long ton on 6,000,000 long tons of sulphur to be produced) and retained not only a reversionary interest in the fraction conveyed (after satisfaction of the sulphur payment therefrom) but [fol. 476] a *continuing* interest in sulphur in place to the extent of $.001328 per long ton produced. Respondent argues, therefore, that the principle applied in those cases is not here applicable.

We fail to see any merit in this argument. Having once determined in the aforementioned cases that the conveyance of a mineral payment constitutes the transfer of property rather than the assignment of income, we see no distinction in carving out that interest in the manner herein employed by petitioner so long as the transaction itself is bona fide. The only particular in which respondent's argument differs from those made by him in the aforementioned cases is as regards the fractioning and, certainly, it is clear that the conveyance of a fractional part of one's interest in income-producing mineral property is not itself regarded by respondent as resulting in tax treatment different from that which would be applicable if the entire interest were conveyed.[3] Moreover, a careful study of the whole record in *Nordan*, as well as in *Wm. Fleming* and

[3] In GCM 12118, XII-2 C. B. 119, respondent stated that a taxpayer's unlimited conveyance, with no retained reversion, of a fraction of his royalty interest (e.g., conveyance in fee of one-half of a one-eighth overriding royalty) may be treated as the sale of a capital asset. Similarly, in I.T. 4003, 1950-1 C. B. 10, 11, respondent's apparent position is that the assignment of an oil payment representing a fraction of the taxpayer's interest, but extending over the entire life of the mineral property, may be treated as the sale of a capital asset.

A. J. Slagter, Jr., all *supra*, reveals that in fact the taxpayers therein did *not* convey their entire interests but, as did petitioner here, carved out the transferred mineral payments from the entire interests which they owned.

(Seal)

[fol. 477] Respondent in his determination of the deficiencies has allowed petitioner percentage depletion on the money received from Munro for sale of the sulphur payment. But petitioner was not the owner of the sulphur royalties at the times he received such money from Munro and, therefore, was clearly not entitled (nor does he claim to be so entitled) to any deductions for depletion. See *John David Hawn, supra*.

Having decided the primary issue in petitioner's favor it is not necessary to decide his alternative contention that, if we should hold that his gains from the sale and transfer to Munro are taxable as ordinary income, then it should all have been reported in 1947, the year of sale, and that none should have been reported in 1948 and 1949.

Decision will be entered under Rule 50.

[fol. 478] In The Tax Court of The United States

[Title omitted]

Decision—Entered December 14, 1955

Pursuant to the Findings of Fact and Opinion of the Court filed September 22, 1955, the parties on December 13, 1955, having filed an agreed computation of the tax, now therefore, it is

Ordered and Decided: that there is a deficiency in income tax for the calendar year 1948 in the amount of $247.77, and that there is no deficiency in income tax for the calendar year 1949.

(Signed) Eugene Black, Judge.

[fol. 479]

Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 480] Minute Entry of Argument and Submission
December 3, 1956

(Omitted in Printing)

[fol. 481] In The United States Court of Appeals for The Fifth Circuit

No. 16105

Commissioner of Internal Revenue, Petitioner,

versus.

W. F. Weed, Individual, and Estate of Eleanor M. Weed, Deceased, W. F. Weed, Executor, Respondents.

Petition for Review of Decision of The Tax Court of the United States (District of Texas)

Opinion—February 1, 1957

Before Hutcheson, Chief Judge, and Holmes and Borah, Circuit Judges.

Hutcheson, *Chief Judge*: This appeal is from a decision of the Tax Court, 24 T.C. 1025, holding that gain resulting from taxpayer's sale and transfer of a sulphur payment carved out his pooled royalty was taxable as long term capital gain.

[fol. 482] It presents the single question whether the proceeds received by taxpayer from the transfer of a sulphur payment carved out of his $.009956133 per long ton pooled royalty interest, which he had owned for years, consisting of approximately 86 percent thereof, effective until the assignee shall have received 6,000,000 long tons of sulphur and no longer, which was expected to pay out within four years but actually paid out in 28 months, constituted ordinary income subject to depletion rather than, as the Tax Court held, capital gain under 1939 Code, Sec. 117.

Here, contending that this case is clearly controlled by, and requires the same result as that reached in, *Commis-*

sioner v. *Hawn*, 231 F(2) 340, and urging that the transfer of a sulphur payment carved out of royalty has no better status than the transfer of an oil payment so carved, the commissioner insists that the transfer was not effective as a sale of capital assets because it was not of a substantial part of the total property owned by taxpayer assignor.

The taxpayer, pointing out that the Texas courts have determined that mineral payment rights in Texas are real property interest[1] and that that view has been consistently held by the Texas Courts, appropriate United States Courts of Appeals,[2] and the United States Supreme [fol. 483] Court, which, in *Thomas* v. *Perkins*, 301 U.S. 655, determined the nature of an oil payment for income tax purposes and established the rule that an oil payment creates an economic interest in the mineral in place, insists that under the undisputed facts of this case,[3] fully

[1] Sheffield v. Hogg, 24 Tex. 290; Tennant v. Dunn, 130 Texas, 285; A. W. Walker, Jr., "Oil Payments", 20 Texas Law Review, p. 259.

[2] Lee v. Commissioner, 126 F(2) 825; Fleming v. Campbell, 205 F(2) 549; Oritz Oil Co. v. Commissioner, 102 F(2) 508; to which may be added Caldwell v. Campbell, 218 F(2) 567 and Commissioner v. Hawn, 231 F(2) 340.

[3] Briefly summarized, these are:

Dec. 23, 1947, taxpayer Weed owned a pooled overriding royalty interest in sulphur produced by the Texas Gulf Sulphur Company from a sulphur deposit in Wharton County, Texas, known as Boling-Dogue; this interest entitled him to receive $.00966133 per long ton of sulphur produced.

At the same time taxpayer was supplying funds and credit for a number of companies of which he was principal stockholder, and anticipated he would need all of the bank credit available to him for these enterprises. Further, he realized that, in addition, he needed a definite source of funds for payment of his individual federal income taxes.

In the fall of 1947, taxpayer negotiated with Munro for the realization of these funds, and transferred to Munro 86.254514% of taxpayer's pooled royalty interest of $.00966133 (i.e. $.00833333) per long ton on six million tons of Boling Dogue sulphur in exchange for $13,900.00 cash and

[fol. 484] set out in the opinion of the Tax Court, to which reference is here made, the transaction constituted the bona fide and effective sale of a substantial mineral interest entitling it to capital gains treatment.

Upon the considerations advanced by the Tax Court and for the reasons set out by us in *Schofield v. O'Connor*, this day decided, we agree with the respondents and with the Tax Court that the gain in question constituted not ordinary income subject to depletion but capital gain.

The Tax Court's decision is therefore Affirmed.

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two notes of $16,300.00 each; the six million tons of sulphur were produced 28 months thereafter.

The taxpayer disclosed the transaction fully in his 1947 tax return, treating the proceeds as capital gains and reporting the profits on the installment basis. Taxpayer's 1948 and 1949 returns reported the $16,300 received from Munro for each such year as long term capital gain. The Commissioner determined that the 1948 and 1949 payments were taxable as ordinary income, subject to depletion. The Tax Court held these proceeds were realized from the sale of a sulphur payment and constituted capital gain.

The following are the pertinent portions of the assignment:

"I, W. F. Wood, in consideration of [$13,900 cash and the two $16,300 notes] * * * do hereby Sell, Transfer, and Assign, unto the said Marion F. Munro, * * * $6.254514 [of $.0039063133 per long ton pooled royalty on sulphur produced by Texas Gulf Sulphur Company at Boling Dome, Wharton County, Texas, from lands and premises described in said above named conveyances [to petitioners from his father and his father's estate] until 6,000,000 long tons of sulphur have been produced and accounted for to the said Marion F. Munro therefrom, which royalty so sold and here assigned and conveyed amounts to $.00833333 per long ton.

* * * * * * *

"This assignment and the royalty transferred and assigned hereby on sulphur produced form Boling Dome * * * shall continue to be effective until said Marion F. Munro shall have received said royalty on 6,000,000 long tons of sulphur and no longer.

[fol. 485] In the United States Court of Appeals for the Fifth Circuit

No. 16105.

Commissioner of Internal Revenue,

versus

W. F. Weed, Individual, and Estate of Eleanor M. Weed, Deceased, W. F. Weed, Executor.

Judgment. February 1, 1957

This cause came on to be heard on the petition of Commissioner of Internal Revenue for a review of a decision of the said Tax Court of the United States, and was argued by counsel:

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby, affirmed.

[fol. 486] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 487] Supreme Court of the United States, October Term, 1956

No. 921

Commissioner of Internal Revenue et al., Petitioners,

vs.

P. G. Lake, Inc., et al.

Order allowing certiorari. June 3, 1957

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.